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UNFAIR COMPETITION WITH SMALL BUSINESS FROM GOVERNMENT AND NOT-FOR-PROFITS: ASSESSING THE CURRENT STATE OF THE PROBLEM AND THE RECOMMENDATIONS OF THE 1995 WHITE HOUSE CONFERENCE ON SMALL BUSINESS

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Unfair Competition with Small Busin...

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

WASHINGTON, DC, JULY 16 and 18, 1996

Printed for the use of the Committee on Small Business

Serial No. 104–86

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Tuesday, July 16, 1996

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS
Washington, DC.

The Committee met, pursuant to notice, at 10 a.m., in room 2359, Rayburn House Office Building, Hon. Jan Meyers, (Chair of the Committee) presiding.

Chair MEYERS. The meeting will come to order. Today, the Committee on Small Business meets to receive testimony on unfair Government competition with small business. As reflected in the statements of today's small business witnesses, it is a very persistent problem. It is one which has proved equally resistant to remedy. Worse yet, as we shall hear this morning and at a follow-on hearing on Thursday, the situation is worsening rather than improving.

Small business faces unfair competition from Government, despite long-held national policy of relying on the private sector to meet the Government's needs for goods and services. Since 1955, the Federal Government has had a formal policy on contracting-out, now referred to as "Office of Management and Budget (OMB) Circular A–76." That policy, however, has been given little more than lip service by the Executive agencies charged with its implementation.

Yet, study after study from the first Hoover Commission of the late 1940s to the most recent Heritage Foundation report of March 1995 all reached the same conclusions. The policy of Government reliance on the private sector is sound and implementation should be improved. Using the private sector to meet Government's needs, can improve service to the public and reduce costs. Yet, our witnesses today will share examples of increased, rather than reduced, Government competition.

Why is this so? As we shall hear, government agencies at all levels are also being encouraged to be more entrepreneurial, to act like businesses. This is certainly a stated principle of the Vice-President's National Performance Review and many of its "reinvention" initiatives.

Federal agencies with workforces that exceed their workloads, are being encouraged to sell services to other agencies who may currently be relying on private contractors. To preserve their in-house capabilities, Federal agencies are selling their services to government agencies at the State and local level. As we shall hear, some Federal Agencies are competing with private firms in marketing services to foreign governments, depriving small firms of "beach-head" overseas marketing opportunities fostered by many foreign governments.

Unfair Government competition is not confined to Government markets. Federal agencies and their State and local counterparts are also entering the commercial marketplace.

And Government competition with private sector firms is clearly unfair competition. The entire operation of Government agencies from facilities to equipment, personnel, and working capital are all supported by tax dollars. Even if competitions are conducted between a Government agency and private firms for the provision of a service, the competition is still unfair. The total costs of agency performance are only in frequently, if ever, accurately captured.

Today's witnesses believe that things are likely to get worse rather than better, because of the recent rewrite of OMB Circular A–76. Rather than strengthening the national policy of reliance on the private sector, the rewrite encourages the agencies to be more entrepreneurial.

Rather than tinkering with A–76, many in the small business community are urging a clear statutory policy of reliance on the private sector. Today's testimony contains strong statements of support for the "Freedom from Government Competition Act" introduced as H.R. 28 by Representative Duncan of Tennessee and its Senate companion, S. 1724, introduced by Senator Craig Thomas of Wyoming.

Whatever the form of the policy, it will require vigilance to have effect. We in the Congress can provide some of that vigilance.

This is what these hearings are about.

I think all of us were impressed when at the 1995 White House Conference on Small Business this issue of Government competition with private business was voted as one of the very top issues. We look forward to our testimony today.

I would turn now to Mr. Skelton to see if he has comments or an opening statement.

Mr. SKELTON. Madam Chair, I appreciate your calling this hearing. I look forward to hearing the witnesses, and it appears we have several.

Thank you.

Chair MEYERS. Thank you very much, Mr. Skelton.

We have first on our witness list today, David Gorin. He is Chairman of the Business Coalition for Fair Competition and is also President of the National Association of RV Parks and Campgrounds.

Mr. Gorin?

TESTIMONY OF DAVID GORIN, CHAIRMAN, BUSINESS COALITION FOR FAIR COMPETITION (BCFC) AND PRESIDENT, NATIONAL ASSOCIATION OF RV PARKS AND CAMPGROUNDS, VIENNA, VIRGINIA

Mr. GORIN. Thank you very much, Madam Chair. Good morning members of the Committee. I am David Gorin. I am appearing here this morning in my role as Chairman of the Business Coalition for Fair Competition, a group of 90 national associations whose members are predominantly small business and who are the victims of Federal Government competition at a variety of levels and in a variety of ways.

Seated behind me this morning is Kenton Pattie, the executive director of the Coalition and one of Washington's top experts in the area of Government competition.

We applaud the Committee for making the effort to find ways to level the competitive playing field between Government and the private sector. But we also find it difficult to understand why it is necessary to be here at all.

In our view, Government is to govern, to protect the life, liberty, and pursuit of happiness of its citizens, not to operate campgrounds, daycare centers, testing laboratories, helicopter services, mapping and surveying programs, or any below-cost, tax-free retail services for select populations.

Where have we gone wrong? How is it that "entrepreneurial Government" is now the buzzword of the nineties, challenging Government officials to seek new ways to expand their reach and justify their existence, while Congress searches for ways to reduce the size of Government, to reduce Federal spending, and to cut the budget deficit? How is it that I am now a customer of the Government, rather than a constituent?

How is it that now when I need information from the Government under the Freedom of Information Act, my first concern is how much will the Government charge me for this information? Yes, it now appears that even the Freedom of Information Act is now a profit center, an entrepreneurial activity in Federal agencies, rather than a vehicle to assure that the American people have access to how Government makes decisions and takes actions.

The Coalition has submitted a detailed analysis of the scope of the issue of Government competition, ranging from the impact of the "National Performance Review", "OMB Circular A–76", and the numerous competitive issues involved in many different industry groups. You will hear this morning from some of those directly affected by the Government's entrepreneurial activities.

I would like to take just 2 minutes to make several additional points. First, as you mentioned, Madam Chair, the last three White House Conferences on Small Business have placed the issue of Government competition high on their agendas.

The last Conference, a year ago, in June 1995, placed this issue as the 14th most critical item of concern to the small business community. The 1,800 delegates said that Congress should enact legislation that would prohibit agencies, tax-exempt- and antitrust- exempt organizations, from engaging in commercial activities in direct competition with small business.

This recommendation came from state small business conferences involving thousands of small business owners across the country, where the delegates complained that the Federal Government was becoming a major competitor with small business.

Second, we know that the leadership of the 104th Congress understands and is in sympathy with the small business community on this issue, but it is time to turn that understanding into action by pushing forward to adopt the "Freedom from Government Competition Act" introduced in the House by Congressman John Duncan and in the Senate by Senator Craig Thomas.

These bills would establish a national policy that all goods and services be procured from private sources. The Business Coalition

for Fair Competition supports these bills which state that Government may only conduct operations that are so inherently governmental that the public interest requires production or performance by a Government employee.

We urge the members of this Committee to join as cosponsors of H.R. 28 and to actively work to include its provisions in any appropriate legislation during the balance of this Congress and if necessary, try again in the 105th Congress next year.

Third, the Administration recently issued a new "Revised Supplemental Handbook on Performance of Commercial Activities, Circular No. A–76." The handbook makes no reference to small business, nor does it provide any encouragement to small business that there might be some improvement in the competitive situation. To the contrary, the new handbook contains new obstacles and hindrances for small businesses that wish to provide goods and services to the Government and reduces the need for Government to work with private enterprise.

Fourth, it has become increasingly clear that the issue of Government competition is primarily a small business concern because these firms are primarily in the service areas, rather than in manufacturing. For this reason, your leadership, Madam Chair, is essential in keeping Congress focused on Government competition, stressing the lost tax revenue it is causing throughout the country.

The written testimony of the Business Coalition for Fair Competition contains a list for 17 possible solutions to the problems of entrepreneurial Government. These solutions range from: passing the "Freedom from Government Competition Act"; to limiting the ability of Federal agencies to sell services to other agencies; to prohibiting Federal agencies from launching business ventures. There are many more possible remedial actions which are included in our written statement.

I thank you again for inviting the Coalition to appear here this morning. When you have heard from the other witnesses, or however you would like to do it, we would be happy to respond to any questions you might have on the subject.

Thank you very much.

Chair MEYERS. Thank you very much for your statement, Mr. Gorin. Our next witness is Rick Hoffmann of the Surdex Corporation of Chesterfield, Missouri, representing the Management Association for Private Photogrammetric Surveyors.

Chair MEYERS. I would like to acknowledge that Mr. Skelton, of course, is from Missouri and Mr. Torkildsen is with us from Massachusetts.

Mr. Hoffmann?

[Mr. Gorin's statement may be found in the appendix.]

TESTIMONY OF RICK HOFFMANN, SURDEX CORPORATION, CHESTERFIELD, MISSOURI, REPRESENTING MANAGEMENT ASSOCIATION FOR PRIVATE PHOTOGRAMMETRIC SURVEYORS (MAPPS)

Mr. HOFFMANN. Thank you. Madam Chair, members of the Committee, my name is Rick Hoffmann, and I am President of Surdex Corporation, a professional mapping firm that is incorporated in St.

Louis, Missouri, since 1954. I am speaking today on behalf of MAPPS, a national association of more than 100 mapping firms.

Through the eyes of small business, eliminating Government competition with the private sector in mapping is a little like Mark Twain's comment about the weather, and we in Missouri know a little bit about Mark Twain. He said, "Everyone talks about it, but nobody ever seems to do anything about it."

OMB estimates $1 billion is annually spent on surveying and mapping in some 39 departments, agencies, and bureaus. Figures from the Office of Personnel Management show nearly 7,000 Federal employees are involved in surveying and mapping positions.

According to information from the Federal Procurement Data System, in fiscal year 1993, only $84.7 million, or 8.5 percent, of the $1 billion in Federal expenditures was contracted to the private sector for surveying and mapping services. Yet, a qualified, capitalized, and dynamic private sector of more than 6,000 surveying and 250 mapping firms have the capabilities to meet and, indeed, exceed those of the Government agencies.

Mapping is an activity in which the Government not only fails to procure from private enterprise, but the Government agencies providing surveying and mapping services compete with private firms. Such competition stifles growth in private industry by dominating certain markets, diverts needed personnel from private sector employment, thwarts efforts by U.S. firms to export their services, and erodes the tax base by securing work that would otherwise be accomplished by tax-paying entities. This is unwise.

The resources now expended to support the Federal surveying and mapping establishment could otherwise be allocated toward more pressing national priorities or used for deficit reduction.

Moreover, the practice is counter-productive from an economic viewpoint, given its impact on the private sector generally, and small business in particular, in the erosion of the tax base. Federal rules and procedures that have historically been in place to protect small business are routinely ignored by Federal agencies.

For example, OMB Circular A–76, first issued in 1955, requires agencies to perform cost comparisons on their activities and contract-out those functions that can be more efficiently provided by the private sector. OMB Circuler A–76 also prohibits one agency from doing work for another agency, if the providing agency has not conducted a cost comparison.

No Federal agency has completed an A–76 cost comparison on surveying and mapping functions. Now, the Clinton Administration has even eliminated this protection in their recent revision of the A–76 manual.

OMB Circular A–97, which implements the Intergovernmental Cooperation Act, prohibits a Federal agency from providing services to a State or local government agency, unless the recipient certifies to OMB that the service cannot be acquired by contract from the private sector. No such certification of a surveying or mapping activity has ever been filed with OMB, yet several Federal agencies regularly do work for state and local governments.

Let me give you some specific examples. One of our member firms in Louisiana spent months developing a mapping project with a parish [county] government in its home State. The firm advised

that parish government that it could qualify for 50 percent Federal matching funds from the U.S. Geological Survey (USGS). What happened when the parish was put in touch with the USGS? The USGS tried to take the project away from the firm.

The National Geodetic Survey (NGS), part of NOAA in the Commerce Department, has been going across the country implementing State geodetic survey networks. In at least two instances, New York and Vermont, private firms worked with their state agencies to develop these projects. When these projects developed, NGS stepped in, took control, and performed these projects with Federal employees.

Our great free enterprise system is based on the laws of supply and demand. The Government should not be the supplier for mapping; it should be the demand for mapping where there is public interest to be served.

To remedy the situation, we would recommend that Congress and the Administration take these steps with regard to generic solutions to benefit the entire small business community:

—Enact H.R. 28 introduced by Representative Duncan of Tennessee, with more than 40 cosponsors and S. 1724 by Senator Thomas of Wyoming, to establish a process by which the Office of Management and Budget will identify Government activities that are commercial in nature, and implement a plan to contract those activities to the private sector during a 5-year period.

—Amend the Small Business Act to expand the responsibilities of the SBA Chief Counsel for Advocacy to identify Federal activities which duplicate or compete with the private sector including small disadvantaged businesses and be an advocate for contracting to the private sector. Current law does not make this a specific responsibility of that office. That should be changed.

—Enhance the responsibilities of the SBA Break-out Procurement Center Representatives to: identify proposed agency equipment purchases aimed at building in-house capabilities that duplicate or compete with the private sector including small disadvantaged business; urge government agencies to acquire services from the private sector, rather than buying equipment to duplicate private sector capabilities.

—Amend the Treasury, Postal, and Related agencies appropriation bill on the House floor to prevent OMB from implementing the revised A–76 handbook that fails to prevent agencies from doing work for other agencies in competition with the private sector.

With specific regard to surveying and mapping, evaluate all Federal programs in order to determine mapping that can be commercially provided. Spending on these programs should be eliminated in order to empower market forces to provide mapping services and redirect Federal agencies to those mapping functions and responsibilities that are more appropriate for the Government, such as, standard-setting, coordination of user-agency requirements, and dissemination of Government data to user-agencies.

We would urge the Committee to include some of these provisions in the SBA programs authorization bill to be marked up later this week.

One final point: Contracting with the private sector should not be viewed as a threat to Government employees. My firm has hired talented personnel from Government agencies, as have many of my colleagues in other mapping firms. Any suggestions that contracting-out would throw Government workers out on the street is a scare tactic and is not supported by statistics.

We thank you for this opportunity to testify, and look forward to working with you to advance these and other solutions to a very serious problem affecting America's small business.

Thank you.

Chair MEYERS. Thank you for your testimony, Mr. Hoffmann. We are glad that you are here.

Our next witness is Molly Greene, who is President of General Engineering Laboratories of Charleston, South Carolina. She is speaking for ACIL, The Association of Independent Scientific, Engineering and Testing Firms and the International Association of Environmental Testing Laboratories. (IAETL)

Ms. Greene?

[Mr. Hoffmann's statement may be found in the appendix.]

TESTIMONY OF MOLLY F. GREENE, PRESIDENT, GENERAL ENGINEERING LABORATORIES, CHARLESTON, SOUTH CAROLINA, REPRESENTING ACIL, THE ASSOCIATION OF INDEPENDENT SCIENTIFIC, ENGINEERING AND TESTING FIRMS AND THE INTERNATIONAL ASSOCIATION OF ENVIRONMENTAL TESTING LABORATORIES (IAETL)

Ms. GREENE. Thank you very much, Madam Chair. A question about the lights. I have never done this before.

Chair MEYERS. They are set for 5 minutes.

Ms. GREENE. OK.

Chair MEYERS. When they turn red, do not feel like you have to break off in the middle of a sentence, just conclude your oral statement as soon as you can.

Ms. GREENE. Thank you.

Chair MEYERS. I might also add, that these mikes are voice-activated. Get close to them, then the people in the back row can hear you.

Ms. GREENE. OK.

Thank you for this opportunity, Madam Chair. While this is the first time I have appeared before a Congressional Committee. I have been involved in several small business activities at the State level. I thank you.

I am representing two trade associations, the American Council of Independent Laboratories (ACIL) and the International Association of Environmental Testing Laboratories (IAETL). I am accompanied by Tony Pagliaro of ACIL; Dave Edelstein of National Technical Systems, a commercial testing laboratory; and Linda Christiansen, the Executive Director of IAETL, the other trade association.

Over 80 percent of our members are small-to mid-size businesses. Most of us are family-owned operations that have grown over the

years, participating in product safety testing, environmental testing, and also testing for health and human welfare.

Our concern is the direct competition from the Federal laboratories that are taking away business from IAETL member firms. The Federal laboratories are now performing tests that are already commercially available. Our understanding is that we should not have to compete with our Government for business.

We recognize the Government's desire to maintain a core analytical capability. The original mission of the Federal laboratories, I believe, was for scientific research, to provide emergency response, and testing high-level radioactive samples that could not be taken from Department of Energy sites.

It is necessary to have Federal laboratories; it is necessary that Federal employees be available for such work.

Our concern is when Federal facilities deviate from that basic scientific mission and are providing traditional environmental chemistry and testing services that are already being provided by the private sector.

Such direct competition limits the business of commercial laboratories in several ways. By using interagency support service agreements (ISSAs), Federal facilities are now able to bypass the procurement contracting procedures that we as private firms are required to abide by. They are able to go into other government organizations and offer services that we have to compete with.

With that in mind, and with my time probably running out, I would like to tell you a little bit about what it means to us personally. As I said, the members of our association are mainly small family-owned businesses that have pulled ourselves up by our bootstraps.

Our company began in 1981. We left corporate America to follow the American dream. We decided we wanted to start our own business and be our own bosses. Well, little did we know that our main competitor would be the Federal Government.

In 1981, our company, founded to do environmental testing and consulting engineering, two of us, had an income of $30,000, while our expenses were $35,000. It does not take a rocket scientist to tell you that this will not work for long. We worked harder. We put in long hours. We succeeded in many people's eyes in fulfilling that American dream.

In January 1986, on January 8th, our company, which had grown to over 200, "restructured". What does that mean? We laid off 10 percent of our workforce because we could not compete with the regulatory requirements and the Federal Government competing with us to do the type of work we do. I would be happy to talk in greater detail on these and answer questions at the end. Thank you very much.

Chair MEYERS. Thank you, Ms. Greene. We appreciate very much your statement.

Our next witness is Elaine Boissevain. Is that the correct pronunciation of your name?

Ms. BOISSEVAIN. Boy-se-vein.

Chair MEYERS. Elaine Boissevain, Owner of Highland Orchards Resort Park, North Stonington, Connecticut, is representing the National Association of RV Parks and Campgrounds.

Ms. Boissevain?

[Ms. Greene's statement may be found in the appendix.]

TESTIMONY OF ELAINE BOISSEVAIN, HIGHLAND ORCHARDS RESORT PARK, NORTH STONINGTON, CONNECTICUT, REPRESENTING NATIONAL ASSOCIATION OF RV PARKS AND CAMPGROUNDS

Ms. BOISSEVAIN. Thank you very much for the honor of appearing before you this morning, Madam Chair. I am Elaine Boissevain, owner of Highland Orchards Resort Park. It's a commercial RV park and campground with 300 sites located in the Mystic area of Connecticut. We have been in the campground business for 25 years.

During 1996, I am pleased to be serving as the national chairman of the National Association of RV Parks and Campgrounds (ARVC), a trade association comprising more than 3,000 commercial campgrounds in every State.

It is in that capacity that I appear before you this morning to urge this Committee and the Congress to take a strong stand for private enterprise and against Government intrusion in our business.

I am accompanied today by the Association's president, David Gorin, whom you heard from earlier when he testified as Chairman of the Business Coalition for Fair Competition.

I congratulate you, Madam Chair, for your leadership of this Committee and for the bold direction you are providing this morning by focusing the Committee's attention on this important issue of Government competition.

I would like to use the time available to me to lay before you several outstanding instances of Government intrusion into our industry, each of which has, or has the potential, to directly harm or displace commercial businesses.

The first instance: In Payson, Arizona, the U.S. Forest Service has spent more than $3 million of Federal funds to construct a 115-site campground just 2 miles from an existing commercial campground. The commercial park was just beginning to earn a profit for its owner but is now close to ruin, will likely close, and most likely will fail to repay an SBA-backed bank loan.

During the scoping process for its new campground, the Forest Service acknowledged that the proposed campground would compete with existing private sector businesses, but proceeded to build the new facility anyway.

Key officials of the Forest Service have acknowledged that the campground should not have been built. Now the Government is turning over its $3 million investment to a concession operator without any requirement that the operator invest any of his own capital or return any of the Government's investment.

The second instance: In Klamath, California, a community located along California's Northern Pacific Coast, the National Park Service operates a free, beach-front campground right along the highway, hosting some 300 RVs on an average spring weekend. The Park Service provides fire rings, portable restrooms, some picnic tables, security, and beach access at no charge to the camping public.

Several existing commercial campgrounds are close to going out of business. The situation has worsened since the Park Service took over this stretch of beach from the California Department of Transportation and opened it up to free overnight camping.

The third instance: The Army Corps of Engineers operates free campgrounds along the shores of many of the Nation's prime lakes and rivers. In the few cases that the Corps charges camping fees, the fees are grossly under market prices and are collected for very short periods each year. When the peak season is over, fees are no longer collected and RVers and others are free to camp at will.

The fourth point: Over the last 10 years, available campsites in the public sector have increased by more than 10 percent, while the number of commercial campsites has decreased a comparable amount.

As below-cost campgrounds serve the public on public lands, commercial, tax-paying businesses are losing. The communities in which they are located also lose. The Federal tax base is eroded. Business shifts from the private sector to the public sector. Taxes paid by the elderly, the poor, and small businesses, like ourselves, support and subsidize these public sector campsites.

Instance number five: The U.S. Forest Service, the National Park Service, the Army Corps of Engineers, and the Bureau of Land Management are now joining together to create a multiagency national campground reservation system that will exclude the private sector from participation and will create a huge competitive business within the Federal Government.

The proposed reservation system will compete directly with existing commercial campgrounds that operate their own reservation services. Exclusion of the private sector puts the campgrounds located in close proximity to these public campgrounds at great risk, as the Federal agencies will seek to keep campers on public land rather than referring them to existing private campgrounds.

The sixth point: H.R. 2107, a bill which would permit Federal land agencies to increase visitor service fees and retain a major portion of the revenue in the park in which the fee is charged will provide new impetus for Federal land managers to increase commercial-style services in order to earn greater income for retention at the local level.

These funds should be used only for maintaining the parks. Unless some limitations are placed on the use of these funds, we fear a growth in the number, size, and amenities in campgrounds operated by the Federal Government.

Let me be very clear on one important item. ARVC does not oppose the operation of campgrounds on public lands, quite the opposite. We believe that public lands provide outstanding camping opportunities that should be available to all.

However, in this era of shrinking budgets and fiscal conservation, we favor relying on private capital to provide campgrounds and camping on public lands rather than Federal funds. We oppose using Federal tax dollars and visitors fees to construct or expand campgrounds or to add utilities and amenities traditionally found in the commercial sector.

With your permission, Madam Chair, I would like to submit a copy of our full statement on public lands and campgrounds to be a part of the record of this hearing.

Chair MEYERS. Without objection it will be included in the record.

Ms. BOISSEVAIN. You will find that statement to be most supportive of our public lands and limiting only in its relationship to Federal funding. Also, Madam Chair, with your permission I would like to have another document entered into the record describing the public sector competitive advantages and our views on how to level the playing field. The paper describes 18 advantages enjoyed by the Federal Government over the private sector, and 12 proposals for how these advantages can be mitigated or overcome.

The campground and RV park industry is not afraid of competition, and, in fact, we welcome it. The more quality camping locations there are, the greater the chance the industry will grow. We seek only a fair chance to compete with other commercial businesses, or, at the very least, with a Government which does not harm its small businesses when it acts like a poorly managed commercial enterprise.

In closing, Mrs. Meyers, we encourage you and the other Members of the Committee to strongly support H.R. 28, the "Freedom from Government Competition Act", and to consider other remedial measures to address this growing problem.

We are concerned that the National Performance Review's "Reinventing Government" and its call for "Entrepreneurial Government" are simply code words for aggressive Government competition with existing commercial industry. Government is not a business, and the citizens of the U.S. are not its customers.

It goes without saying that we deserve and expect fair and courteous treatment. We are constituents, not customers to be catered to and won over. Let Government govern, and let the free enterprise system provide the economic strength needed by the United States. Please take steps to assure that the Government does not overstep its bounds.

Thank you very much.

Chair MEYERS. Thank you very much, Ms. Bossevain. It is very nice to have you with us.

Our next witness is Nancy Granese.

[Ms. Bossevain's statement may be found in the appendix.]

TESTIMONY OF NANCY GRANESE, DIRECTOR OF GOVERNMENT RELATIONS, NATIONAL CHILD CARE ASSOCIATION, ARLINGTON, VIRGINIA

Ms. GRANESE. Thank you, Madam Chair.

I am a governmental affairs adviser for the law firm of Hogan & Hartson in Washington, DC. I am here today representing the National Child Care Association (NCCA), for whom I serve as Director of Government Relations. I appreciate this opportunity to address the Committee.

This statement summarizes that which would have been read by Katherine DePuydt, an NCCA board member. Unfortunately, her plane from North Carolina last night was canceled, and she could not be here.

Katherine and Bill DePuydt own and operate licensed proprietary child care centers in Vermont and North Carolina. Their story is indicative of the unfair competition which small business people in the child care industry confront every day.

Sixteen years ago, the DePuydts built their first center in St. Albans, Vermont, a city of less than 7,500. At the start, they were the only teachers. Eventually, their business grew to employ 15. Currently, they have only seven employees in St. Albans.

In 1994, the Immigration and Naturalization Service (INS) built a new facility in St. Albans with plans to include a child care center. Since the DePuydts center had provided year-round care for the children of many INS employees, this immediately cut into their pool of customers.

If the INS child care center was not fully utilized by INS employees, 50 percent of its enrollment could come from the general public. Thus, the INS had its sights on the DePuydts other customers as well. The INS intended to contract with the YMCA, an organization which pays no tax on its income, to run the child care facility.

Late in 1994, Mrs. DePuydt was invited to submit a bid to operate the center, despite the clear signals that the YMCA would run it, since the Y had been helping the INS plan its child care program with that understanding.

However, the board had been instructed to solicit bids, even though the Y had not expected to be forced to compete for this contract. The DePuydts now believe that this bidding process was a sham. The INS established its child care center as an independent corporation free to act at its own discretion, and not required to comply with any Government contracting rules.

The DePuydts had 3 days to submit a bid, after which they heard nothing until March 1995. Their bid was rejected, despite offering more services at a lower price than those proposed by the Y.

Mrs. DePuydt then tried to determine why her bid was rejected. She was shuffled from one office to the next, and eventually her request for information was referred to the president of the INS child care center board of directors, but she has heard nothing further.

The YMCA-run child care center at the INS facility is now open. It advertises extensively to the general public. The INS, a Federal agency, provides a state-of-the-art facility, including, furnishings, utilities, phones, and computers. The YMCA need only supply the staff and consumable supplies. This is the stuff of any business person's dreams. No small independent business can hope to compete in these circumstances.

The DePuydts risked everything to establish their business. After 16 years of employing and training many people and after 16 years of paying taxes on every dollar of their income, their business is being undermined by a collusion of the Federal Government and a large, tax-exempt organization. The tax dollars paid by the DePuydts and their employees are subsidizing a program run by a subsidized organization in direct competition with their tax-paying business.

Why did the INS decide to establish a large child care center in a small town that already had adequate, quality child care available? No one knows.

Unfortunately, this situation is repeated all over the country. Federal agencies operate child care centers in direct competition with NCCA members every day. Private child care centers provide quality care and education for our youngest citizens and support Government through taxes on their income.

The industry is more than happy to provide child care services to Federal employees, and does so with great frequency. But the industry does not care to compete with the Federal Government in providing those services, in fact, it cannot compete and survive.

I appreciate your time. I want to say that Mrs. DePuydt wrote this statement herself. I simply changed it this morning to accommodate my delivery of it in her place. I ask that NCCA's complete statement be included in the hearing record.

Chair MEYERS. Without objection it will be entered into the record. We are thankful that you were with us this morning, Ms. Granese.

Our last witness is Frank Jensen, president of the Helicopter Association International of Alexandria, Virginia.

[The prepared statement of the National Child Care Association may be found in the appendix.]

TESTIMONY OF FRANK L. JENSEN, JR., PRESIDENT, HELICOPTER ASSOCIATION INTERNATIONAL, ALEXANDRIA, VIRGINIA.

Mr. JENSEN. Madam Chair and Mr. Jackson, thank you for the opportunity to discuss with you this morning the subject of Government competition. As you have heard repeatedly, it is a matter of increasing concern to the entire small business community.

For the past 48 years, the Helicopter Association International (HAI) has dedicated itself to promoting the safe operation of civil helicopters. I would like to emphasize that HAI strongly supports the rule of law as absolutely essential to protect the citizenry and to facilitate commerce.

We understand the need for a realistic Government structure to serve the needs of the citizenry: defense, emergency services, law enforcement, and the like. Our members represent more than a thousand small businesses that put helicopters to work by flying a wide range of missions that fill market demands in a number of areas, including agriculture, energy, tourism, fire fighting, construction, ambulance service, and many more.

Governments at all levels also perform tasks that could only be accomplished by the use of helicopters. We both use the same kinds of helicopters; we both carry people and payloads.

The trouble starts when Government aircraft step out of their legitimate functions and compete with the private sector by working for hire. Even when Government helicopters work without compensation, they still take work away from small business operators. This, in turn, cuts into the tax base, which funds every level of Government. Such action by Government agencies requires us to examine the philosophies that make us the great republic that we are.

Government must govern. It must be the "traffic light" and not the traffic. Let governments govern and private industry produce

goods and services. That is what made America the great power which it is today.

Our membership is greatly encouraged by the fact that Congress is now seriously considering the "Freedom from Government Competition Act". Every time Government aircraft patrol power lines or transport patients between hospitals, haul goods or carry sightseers, that reduces the number of aircraft that private sector operators can purchase and the number of employees that we can hire.

In the big picture, it also cuts into the tax base that makes all Government possible and it raises taxes — a vicious, destructive spiral where everybody loses.

We have many examples of how Government aircraft operators are cutting into the work that rightfully belongs to the private sector. This encroachment is both direct and indirect. Many times these Government operations become absolute monopolies. I can cite many, many instances where this is true. I have provided examples in my written statement.

Please keep in mind that many Government aircraft are self-insured by taxpayer pockets. In the event of mishap, the tax payer loses again. These Government aircraft are not held to the same high FAA standards of maintenance and personnel training as is the private helicopter operator.

Adding to the problem is the fact that the Federal Government provides local and State governments with a huge supply of free military surplus aircraft, which have no FAA-approved maintenance records. In fact, the Government pilots are not even required to be FAA licensed. Nevertheless, they fly over our homes and schools every day.

Regardless of policies or laws, governments are charging into the marketplace from every direction, not only helicopter operations, but, as you have heard, just about every area of commerce. Again, these often constitute government monopolies that the private sector cannot even penetrate.

The only way to preserve American prosperity is to stop this insidious erosion of our economy, including our tax base. The line between Government and private enterprise must be drawn at the threshold of Government.

Again, HAI supports and applauds this Committee's efforts and your personal efforts, Madam Chair, to protect small businesses from unfair government competition. Such laws will also protect the government's lifeblood: A growing tax base.

I have great trouble understanding why Governments, particularly at the State and local level, do not seem to tune in on that frequency. They do not seem to understand that they are destroying themselves by biting the hand that feeds them.

The 1995 White House Conference on Small Business advocated strengthening OMB Circular A–76, you heard it mentioned several times already, and by blocking Government and tax-exempt entities from new commercial pursuits. The OMB Circular A–76 process has never been an effective enforcement tool, and it certainly is even worse now than it has been previously.

Public Law 103–411 would also be a great step if it were enforced. This law would prohibit public aircraft from poaching commercial work from private operators. Its enforcement would help

stem the tide of government encroachment into private sector helicopter operations.

However, since being signed into law in October 1994, there has not been a single violation of that law prosecuted by the FAA, although we have given them probably a hundred examples of violations.

Basic American values are vital to this debate. A vibrant tax base is crucial to driving America's prosperity and sovereignty. The degree to which governments govern and refrain from engaging in private enterprise is the degree to which America will prosper, which is why HAI wholeheartedly supports passage of H.R. 28.

Again, I thank the Chair and the Committee for hearing my testimony. Thank you.

[Mr. Jensen's statement may be found in the appendix.]

Chair MEYERS. Well, I thank you very much, Mr. Jensen.

Let me say that although we had conflicts and some Members have not arrived yet, they will probably arrive before noon. They are just not back yet from weekend responsibilities in their districts. I would like to request that we be able to submit questions for the record. I think Members will have questions they would like to ask, if you would respond to them,

I will start the questioning, and then turn to Mr. Jackson. Ms. Greene, I think you were about to elaborate on a personal experience, and I would like to give you the opportunity to finish that. I would like to have you talk about the impact of Government competition with commercial testing labs and any specific examples that you would like to give.

Ms. GREENE. I was watching the lights very closely. I appreciate the opportunity to elaborate a bit.

We work with industry and the Federal Government in the environmental testing business now. What has happened is the Federal Government has certain requirements, and I will give you a good example of where we do not have a level playing field.

We are required to pay a laboratory technician, under the Service Contract Act, the prevailing wages of our area. Now, I live in Charleston, South Carolina, and the U.S. Department of Labor has determined the prevailing wages for an environmental technician who may have no degree up to a doctoral degree, is $13.87 an hour for entry level.

That is more than we would pay a 4-year, degreed chemist who is fresh out of school coming to work in the environmental testing industry. That causes our labor rates to go sky high. Federal laboratories and State-owned laboratories are not required to pay a person fresh out of school or with no degree, that hourly rate. That is one example.

For us to compete for Federal procurement opportunities we must put together large proposals and than wait sometimes for years before a contract is awarded. In the end, the work may be taken back in by the Federal laboratory to avoid of laying off or reducing its staff.

The Federal laboratories do not have to abide by the certification processes that apply to independent laboratories. They do not have to spend the thousands and thousands of dollars to obtain certifi-

cation or the manhours to be audited by agencies coming through our facilities constantly.

Our industry is in a state of chaos. It is a shrinking market. Instead of going through the natural process of business cycles, we are gasping for breath all throughout our industry.

Prices are being slashed to keep doors open. Companies are closing their doors that have been in business for 20 years. One of the significant reasons is because of competition from Federal Government laboratories.

Chair MEYERS. Thank you for your response, Ms. Greene.

Ms. Bossevain, I have been concerned about the Government restricting "full and open competition" for Government contracts. We have seen efforts to replace the current statutory standard of full and open competition with an open-ended standard, "maximum practicable competition". In other words, when it is convenient for the Government, they will allow competition. I opposed that vigorously on the floor with a number of my colleagues, and we lost, but prevailed in the end during conference with the Senate.

I am telling you these things because I think maybe in some respects the problem may not be exclusively with agencies, but it may also be with us in Congress. You may have some work to do with the Members.

I have offered a bill for several years that would require full and open competition for concessions in national parks. Right now, the National Park Service is not allowed to set any floor, and there is a right of renewal for a concessionaire there now. When they open it for bidding, the incumbent concessionaire has the right to say, "I will meet the best low bid."

Obviously, no one bids because it costs substantial money to prepare a bid. You know you are going to be beat the minute you walk in the door. I have been trying to change those rules, but I just cannot get it done.

I do not know whether it is just a resistance to change. But it is a problem throughout the agencies, not just the National Park Service, but the Forest Service and Bureau of Land Management and Corps of Engineers, all of them have concession bidding procedures that, I think, could be improved.

Could you elaborate a little on that kind of problem? Have you ever tried to bid, or do you know if your members have tried to bid, to get a concession in any of the Federal agencies?

Mr. BOISSEVAIN. Well, I certainly appreciate your attention on that matter.

ARVC has a position on concessions: "ARVC supports the awarding of concessions, permits, and contracts to the private sector for the commercial operation of recreation areas that provide services to the public that are inherently commercial in nature, and for which there exists a private sector industry capable of serving the needs of visitors to public lands."

We also have policy regarding the award of concessions. Could I have David elaborate on that?

Chair MEYERS. Yes. Mr. Gorin?

Mr. GORIN. That is an interesting issue that you bring up. I am well aware that there have been problems in passing concession reform legislation.

In the campground industry, specifically in the national parks, there was a pilot project to concession national park campgrounds back in the late 1980s. The program was so successful that the Park Service decided not to do it any longer and to keep the operation of the campgrounds within the agency. They are now reviewing that policy to find out whether or not campgrounds ought to be concessioned. The Park Service has not made those opportunities available.

In the other Federal agencies, the Forest Service has been very aggressive within the last one or two years in seeking out concession operators. In some cases, they have been very successful.

Of course, they have a wonderful practice of bundling concessions where you get one real good one, but you take three dogs along with the good one, one profitable, three unprofitable ones, which is making it harder and harder for anybody to take on those concessions. It is certainly an issue that we are working hard with a lot of the Federal agencies.

Chair MEYERS. Thank you. Let me ask one more general question. Anyone who wants to can respond. Then I will turn the questioning to Mr. Jackson.

The small business community is deeply concerned with the recent rewrite of OMB Circular A–76. Several of you have mentioned this. Can you elaborate on some of the key concerns, especially the Circular's encouragement of agencies to enter into interagency service support agreements, ISSAs?

Would you like to start, Mr. Gorin?

Mr. GORIN. Sure.

The OMB revision now allows that any work being done by 10 or fewer Federal employees can be kept in-house, with no cost studies being required. That is clearly going to impact thousands of small businesses that could compete for that kind of work.

In terms of the interagency service support agreements, there was one, that just came to my attention just the other day, by the Bureau of Reclamation, which is primarily a western agency dealing with water resources, under which its engineers are being sent to Philadelphia to do work for FEMA, the Federal Emergency Management Agency.

When asked who had done that work in Philadelphia, it was found that it had been contracted-out to engineering firms in the area. Obviously, the Bureau of Reclamation had some extra people on hand, so they sent them to Philadelphia.

I think interagency service support agreements are going to become more and more prevalent as agencies market their services to other agencies, under "Entrepreneurial Government", and as they are now permitted to do under OMB Circular A–76. It is certainly something that is going to discourage small business from participating further in service contracting operations.

Chair MEYERS. Would anyone else like to comment on that, Mr. Jensen?

Mr. JENSEN. Yes, Madam Chair, I would. First of all, I know of instances where Government agencies have actually conducted classes on how to "cook the books" under the old A–76 to make them appear to be financially competitive with the private sector. That is point number one.

Point number two: the proportion of Government employees at all levels who are unionized compared to those in the nongovernment workforce is about six to one. That is about one of the toughest nuts that we have to crack. Because when we take on a county, for example, for illegitimate use of a helicopter, we suddenly find ourselves confronted with the American Federation of Government and Municipal Employees, the AFL–CIO, and others.

When we go to the Federal Aviation Administration and ask, "Why are you not enforcing Public Law 103–411?"; the answer is, "We have to get the inspector's handbook approved by the union."

I do not know what can be done, but I am telling you that: Number one, the Government conducts classes on how to defeat the cost comparison provisions of A–76; number two, the unions are an incestuous part of the very difficult problem that we are having with contracting-out.

Chair MEYERS. Mr. Hoffmann?

Mr. HOFFMANN. Yes. Madam Chair, John Palatiello is the Executive Director of MAPPS, the Management Association for Private Photogrammetric Surveyors. At breakfast this morning, he was telling me a rather interesting story about one of our Alaskan members. Could he present a little bit of that story.

Chair MEYERS. That would be fine.

Mr. PALATIELLO. Thank you, Madam Chair. I am John Palatiello.

Chair MEYERS. Please pull up a chair. That looks a little awkward.

Mr. PALATIELLO. Thank you, Madam Chair.

As I am sure you are aware from the newspapers, there was a tremendous problem with a rather significant forest fire just north of Anchorage about 2 months ago. We were very surprised to see an article in *USA Today,* that the CIA provided satellite imagery, aerial photography, and mapping to the Forest Service.

What was more astounding was that there was an attribution to the head of the CIA's National Photographic Image Laboratory in which he said that the CIA would only do this if there was no private sector source.

Well, ironically the president of MAPPS, who is here, is from Anchorage and his firm is the preeminent aerial photography and mapping firm in Alaska. He was flying that fire for some private timber companies and had the imagery, had the mapping. No one every contacted him.

That is just one recent example of where not only are the Federal agencies exercising this entrepreneurial spirit to do work for other agencies, but they are disregarding their own words and, in fact, violating established Federal policies that Congress and the Executive over many, many years have put in place to protect small business. The existing policy and procedures are not working, they are being blatantly disregarded, to the disadvantage of small business.

The same thing is true with regard to not only the Federal interagency support agreements, but also, as Mr. Hoffmann indicated, to work for State and local governments. Again, there is a protection in Federal law and in Federal policy, but it is never complied with.

The U.S. Geological Survey, for example, has authority under a separate OMB Circular, A–16. This circular governs coordination of

Federal surveying and mapping activities and it assigns to the U.S. Geological Survey the lead responsibility.

They actually have the authority under A–16 to send a memo to every other Federal agency during the budget process and ask, "What are your needs in the next fiscal year?" and then decide which of those needs they want to fulfill.

Talk about preserving "full and open competition", for these surveying and mapping there is never any competition. They are exempt from the Competition in Contracting Act, exempt from the Federal Property and Administrative Services Act because the agencies do an interagency transfer. These opportunities are never published in the *Commerce Business Daily*. We often do not even know about these opportunities until after the fact.

Chair MEYERS. Well, this is very helpful. I appreciate your comments. Would you identify yourself for the record, please?

Mr. PALATIELLO. My name is John Palatiello, I am Executive Director of MAPPS.

Chair MEYERS. Thank you very much.

Mr. PALATIELLO. Thank you, Madam Chair.

Chair MEYERS. Mr. Jackson?

Mr. JACKSON. Let me thank you, Madam Chair. Before I begin with my initial remarks, I certainly want to ask that my opening statement be entered into the record at the appropriate place.

Chair MEYERS. Without objection.

Mr. JACKSON. I want to thank the panelists who are here today who have talked with us about H.R. 28, which is certainly coming before the House in the not so distant future.

Madam Chair, I have a lot of concerns about this particular bill and its impact. I am not quite so sure after having listened to some of the panelists, quite frankly, where I fall on this issue.

As you probably well know, the Government plays a significant role in inspiring, if not motivating, and offering incentives into our economy for small businesses to begin and to grow particularly in low-income areas like the Second Congressional District of Illinois, that I represent.

But for the Federal Government and its involvement in many areas, the free enterprise system by its very nature has ignored many low-income and impoverished areas. But for Government involvement, helping businesses, there would be no enterprise in these areas at all. I am very concerned about that.

For example, I am not so sure of H.R. 28's full impact. Let us say, in every major city in the Nation there is an athletic stadium. In order to build that stadium, each of those stadiums was provided some Federal benefits to make it happen: some Federal tax dollars, some Federal tax break, or some local tax break to make it happen.

Maybe even in the case of the Chicago Bears, for example, an arrangement with the City of Chicago to keep the Bears in the city, a local government benefit. Yet, the Chicago Bears, the Chicago Bulls, and others may not even do business with small businesses in the City of Chicago, a city where people have to wash uniforms, people have do to things along those lines.

In many instances because of certain "isms" that exist in our society, many of those businesses never consider doing the laundry

business of a team with, let us say, an African-American or an Asian-American or a business that is headed by a woman.

Now, do we, in turn, suggest that it is unfair for the Government to look at businesses that are headed by women or businesses that are headed by African-Americans or businesses that are headed by Asians that normally would not be able to compete in the free enterprise environment because they would be overlooked?

Or, do we, for example, let the Government play some role, and what the discussion of that role should be is a matter for all of us to determine and try to hash out, in the free enterprise system?

As I listened to Ms. Boissevain, or maybe it was Ms. Granese, who raised the concern about day care, I recalled a woman who called my office last night from our district and said, "But for Government-sponsored day care, I would not be able to afford day care." placing an inordinate burden on her income and on her family.

I guess my question is for all of the panelists: Is there a balance that can be struck? The President gives a State of the Union speech every year; he proposes a budget every year. Based upon the priorities of the President and Congress, free enterprise then takes its cues from the Federal Government.

The Federal Government plays a role in all of our businesses, whether we consider it to be fair or unfair competition, it plays a role in directing what the national priorities are in our economy.

Is there a role other than "We want them out" that the Federal Government can play in correcting either historical injustices for businesses that have been headed by women or by minorities? Do you see any benefit at all in the Federal Government being involved in the free enterprise system?

Ms. GRANESE. Mr. Jackson, I am the person who represents the National Child Care Association. I would be happy to make at least an initial response. We are delighted to bid on any contract that exists, and our proprietary child care centers do that quite frequently. In fact, we have a very active Illinois child care association, and many of our members are in Chicago.

I do not think that any NCCA member would be reluctant to move forward in a partnership with the Federal Government in any disadvantaged community. We have a slightly different problem in our industry in the sense that we compete with the public school system, we compete with grandma, we compete with the neighbors, we compete with churches, we compete with a number of groups all of whom provide a valuable service.

NCAA members must be licensed. We are told in every State in the Union how many employees we must have, based on our customer population. When we face a situation in which our members do not have the opportunity to bid on a child care center, it is a very frustrating thing. They are small business people. The vast majority of our business owners are women. I think there is no particular disagreement with your initial point.

I might also point out that there is built into Federal law a bias against proprietary child care centers in the sense that in order to participate in the Child and Adult Care Food Program, for example, which is designed to help children who receive Title XX fund-

ing, to receive a food subsidy at a child care center, different standards apply.

If you are a nonprofit provider of child care, you need have only one Title XX child in your center, and then all your children are eligible for a subsidy. If you provide child care in a home, you get the same subsidy if you have only one child receiving Title XX funding, even if it is in Potomac, Maryland.

However, if you are a for-profit provider of child care — that is, simply you file a tax return — 25 percent of your child population must be eligible for Title XX funding. They must actually receive it before you get a subsidy for any child.

If you have a hundred kids in your center, it is not sufficient that you have 24 who are eligible. The center across the street run by a nonprofit organization, which, by the way, simply has to fill out a form saying it is nonprofit, it can be otherwise identical to the for-profit child care center across the street, but all of not-for-profit center's children will get subsidized.

We have raised this issue several times. I would be happy to come in and work with you on trying to get that changed through the Agriculture Committee or through the Economic and Educational Opportunities Committee.

The truth is that we are perfectly happy to compete for a contract on an open and uniform basis, because currently, Government contracting is different in every agency, depending on who runs the facility. I am sympathetic to what you say, but I think that there is clearly room for compromise. I do not know whether it is this legislation.

Mr. JACKSON. I really respect that, and I really appreciate the spirit of your remarks. I am, again, just looking for the balance. I think this body is under some obligation to strike the balance between unfair competition, which you just stated in your example, and places in our Nation where the market is not functioning properly.

Mr. JENSEN. I would like to comment on a philosophical point, if I may, and also then tie onto the dual standards of regulations. I have been friends with some investigators from the Small Business Administration for many years, and abuses of the 8(a) Set-Aside Program have been just legend.

For example, there have been absolute instances of people changing their name to a Spanish surname so they could qualify as a minority under that law. For women businesses, in some cases the woman has no expertise at all or no direct part in the operation of the business, but she purports to be so she can qualify for 8(a) set-asides. While there is definitely a need for some kind of help within inner cities and other areas, they really need to be policed very carefully.

Now, as to the standards, the dual standards, I would like to comment that the Forest Service and the Department of Interior and the Bureau of Land Management and all of these others have very, very high standards to which the commercial operator must operate: A certain height of skids, certain kinds of radios, certain qualifications of the pilots, and many, many other things.

Then they turn right around for the same fire and they bring in the National Guard and some pilot with only 200 hours of flight

time, aircraft improperly equipped, the guy has no idea what he is doing, and they get in there and they really create dangerous situations for the professional firefighters. The point is that the same standards that apply to child care, that kill the small business, apply to firefighting and helicopter operations.

It is something that the Federal Government really needs to take a look at. Is this smart to have one set of standards for the private sector and to have another totally different set of standards for Government?

Mr. JACKSON. Let me if I can, and, Madam Chair, I will gladly relinquish the floor to you, because he did raise the question about 8(a)——

Chair MEYERS. I want to comment on that also.

Mr. JACKSON [continuing]. something that is kind of dear to my heart, Madam Chair.

Chair MEYERS. We probably are not on the same side.

Mr. JACKSON. I respect your position about abuse in the system. I think that there is no doubt that the Government should offer some constructive arrangements for fixing that abuse. But if there is a need which the 8(a) Program has certainly identified, at least as it was conceived to address a particular need in our society, we should address that.

I mean, when you consider protective markets, when you consider affirmative action, something to offset Government-negative action for centuries or even in current times against groups of people, we should certainly within this body consider what is necessary to address those needs.

For example, even when you consider affirmative action in my State, the number one beneficiary of affirmative action are white women, not African-Americans, but white women. The abuse that exists in our State are those white male-predominantly run organizations, either large or small business, where they put their wives in business because they qualify as a minority to benefit from the program. Now, I find that abusive. I find it abusive when someone changes their name to apply for the program just so their name sounds Latino; I find that to be abusive.

However, when you consider the vast majority of contracts that the Federal Government awards on a bid or a no-bid basis, that there are organizations and companies headed by white women, by African-American women, and by Latinos that cannot participate then we have a fundamental problem that still needs to be addressed.

Something about that is not fair, particularly when you consider the communities that they are from. However, I again thank the gentleman for his remarks.

Madam Chair, thank you so much.

Chair MEYERS. Mr. Jackson, I will not take the time to debate the issue this morning, because I am sure we are going to have the opportunity later. I do intend to introduce a bill, and it will be considered in this Committee, that would phase-out the 8(a) set-aside and end it.

I am certainly not against affirmative action, and I have worked for every civil rights and voted for every civil rights program that has ever been in front of me. However, I think the programs that

were very worthwhile and needed 20 or 30 years ago because of the civil rights actions that we have taken over the years may not be necessary now. Certainly, 8(a) has many, many problems, for example, the fact that women are not allowed to participate, Caucasian men are not allowed to participate, only minorities.

All that aside, my principal problem with 8(a) comes back to the thing we are talking about today. It is inherent in the bill that I introduced that has to do with bidding on concessions in Federal parks; it is inherent in my fight this year to maintain full and open competition in the award of Federal contracts.

The principal problem with 8(a) contracts is that they are sole-sourced. They are just handed out, and that is wrong. We should change that and change it immediately. Some of these programs may have been necessary once. I do not think they are necessary now. I think minorities in this country are fully able to compete.

Ms. Greene, I think you wanted to respond to Mr. Jackson's question.

Ms. GREENE. Yes. Thank you very much.

Mr. Jackson, what I would like to do is separate the issue of competition from the Federal Government from the issue of some type of assistance from the Federal Government. In the type of work we are doing, in environmental testing, there are many set-asides for small disadvantaged businesses.

We are a woman-owned business. I am not in the category of small disadvantaged. When we win contracts, we look to small disadvantaged businesses to subcontract some of our work.

The criteria that is so disturbing is they are also being penalized and burdened by this Service Contract Act to pay the $13.87 an hour to someone with no degree, to give them health and welfare benefits that are over and beyond the realistic health and welfare benefits that are given. They are also being penalized instead of getting some assistance.

What we are talking about here, competition from Government, is also taking away work from small disadvantaged businesses. The market is shrinking. When we have the Federal Government competing there is no level playing field, we are all suffer. Tony has something to add.

Chair MEYERS. Please identify yourself.

Mr. PAGLIARO. I am Tony Pagliaro.

To separate the issue even more fundamentally, Mr. Jackson, would you rather have the work to build that new stadium in your district performed by a contractor from your district, or would you rather have it done by the Army Corps of Engineers?

I will be submitting for the record a memo from the Department of Defense that actually says they now have the authority to start whatever kind of business they want to.

They are out there doing construction for stadiums, doing the engineering work, doing testing laboratory services. They started university work. They are justifying themselves.

Molly just brought to my attention, with regard to interagency support agreements, page A9 of today's *Washington Post* now we all know that we should not be drinking this water.

Mr. JACKSON. It's imported.

Mr. Pagliaro. The people who are doing DC's water testing on behalf of the EPA, is another government entity located in Iowa, no less. There is not a qualified organization in Virginia, Maryland, or DC? "Technopolitics" to do this? Why do we have to have a government sponsored organization, at a state university, doing this for us? This is not rocket science.

What we are saying here is separate out the 8(a) issue. We are not here for that.

What we are here to say is this is hurting all small business, no matter what your status, because of "Entrepreneurial Government".

They are out there competing against all entities of the private sector. Government competition is an issue for all small business and should be on the very top of your agenda.

Thank you.

Chair MEYERS. Well, I appreciate your remarks, Mr. Pagliaro.

Do you have any closing remarks or closing questions, Mr. Jackson?

Mr. JACKSON. No. I just want to congratulate the Chair for having the courage to call today's hearing. It is a very, very tough subject, a which-comes-first, the-chicken-or-the-egg, what role the Government should play in the free market system. I congratulate you, Madam Chair.

Chair MEYERS. Thank you very much, Mr. Jackson.

We are very pleased to have you all with us today. We may be submitting some written questions to each of you. The hearing is adjourned.

[Whereupon, at 11:30 a.m., the Committee was adjourned, subject to the call of the Chair.]

THURSDAY, JULY 18, 1996

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to notice, at 9:30 a.m., in room 2359, Rayburn House Office Building, Hon. Jan Meyers, (Chair of the Committee), presiding.

Mr. SALMON. [Presiding] Welcome to the Small Business Committee. We are very pleased to have such a distinguished panel of witnesses today. Today, the Committee on Small Business meets to receive further testimony regarding unfair competition with small business.

This hearing is a continuation of the Committee's efforts to explore an issue that was voted 14th among the top 60 recommendations by delegates to the 1995 White House Conference on Small Business.

A similar recommendation was ranked third by the small business delegates to the 1986 White House Conference, and among the top five recommendations during the first White House Conference on Small Business in 1980.

This past Tuesday, the Committee looked at a core component of this small business issue—direct competition by Government entities. On June 27th, the Committee explored the competition small business faced from the expansion of Federal Prison Industries. This, too, has been an issue which the Committee has afforded the small businesses an opportunity to share their experiences and voice their support for remedies, legislative or otherwise.

Today's hearing focuses on a different component of the unfair competition issue. Unfair competition provided by various forms of not-for-profit entities. Such organizations have been accorded broad advantages by statute and other Government action. To the small business owners with whom they compete, whether for Government contracts or commercial business, these many preferences put many small firms at a serious, if not insurmountable, disadvantage.

Our first witness, the Vice Chairman of the Business Coalition for Fair Competition, will provide a broad context of what the White House Conference delegates saw as this component of the issue of unfair competition with small business. Subsequent witnesses will provide specific examples of advantages enjoyed by these not-for-profit entities. They will also demonstrate that like unfair Government competition, the problem is a growing one. The reasons are approximately the same, financial pressures to be more and more entrepreneurial as their traditional sources of funding have dried up.

This component of the unfair competition issue also includes competing policy tensions that pervade this entire issue. It is espe-

cially prevalent when exploring the competition provided by the broad array of not-for-profit service organizations. They provide valuable services to their communities.

Indeed, they serve populations within those communities that rely deeply on the assistance they provide. This is especially true of programs run by the various organizations serving the blind and severely handicapped.

I look forward to the testimony of today's witnesses.

Let me introduce our distinguished panel of witnesses: Thomas J. Scanlan, Vice Chairman, Business Coalition for Fair Competition, Washington, DC; Michael Liberman, president of Valley Forge Flag Company; Philip C. Hanson, vice president of C.H. Hanson Company; Evan J. Kemp, Jr., Evan Kemp and Associates; Robert P. Stack, president, Community Options; Gene Meier, owner, Lewistown Propane and Fertilizer; Roger S. Ralph, president, Bel Air Health Club in Bel Air Maryland, representing International Health, Racquet, and Sportsclub Association; Dr. Charles A. Garber; Michael K. McGee, National Environmental Testing, Inc., representing the International Association of Environmental Testing Labs; and Lou O'Brien, Chairman, Model-Star Services.

Do any of the other Members have opening statements?

TESTIMONY OF HON. NORMAN SISISKY, U.S. REPRESENTATIVE FROM VIRGINIA

Mr. SISISKY. Mr. Chairman, I would ask unanimous consent to put the statement of the Honorable John LaFalce, who is the ranking Member, into the record.

Mr. SALMON. Without objection, so ordered.

Any other comments from those up here?

Mr. SALMON. If not, we will get started. Mr. Scanlan.

[Mr. LaFalce's statement may be found in the appendix.]

TESTIMONY OF THOMAS J. SCANLAN, VICE CHAIRMAN, BUSINESS COALITION FOR FAIR COMPETITION, WASHINGTON, DC

Mr. SCANLAN. It is an honor for me to be here today and to start the discussions going on what is a very serious problem for thousands of small businesses all across the United States.

The Business Coalition for Fair Competition (BCFC) has been in existence for over 12 years. I have been able to be associated with it for 9 years. The Coalition represents a wide variety of organizations whose members are terribly affected by the extraordinary benefits that not-for-profits have in competing with taxpaying for-profit businesses.

Among the members of the BCFC are: The American Council for Independent Laboratories; the American Bus Association; the American Society of Travel Agents; the Colorado Coalition for Fair Competition; the Helicopter Association, the International Health, Racquet, and Sports Club Association; and numerous others some of whom are here before you today. Their small business members will be speaking directly of their experiences in trying to deal with the unlevel playing field that they have to face when they do business.

I would like to highlight what you said, Mr. Salmon, this is just not a number of trade associations that are concerned about this problem. Small business representatives from all over the United States, convened in the White House Conference on Small Business, both in 1986 and in 1995, voted unfair competition from nonprofit organizations and from governments among the top 15 issues.

Another thing that I think we should emphasize as we look at this problem in its broadest perspectives is that this is a problem that is growing, not diminishing. From 1975 to 1990, the not-for-profit sector grew by 150 percent, while the gross domestic product grew about 50 percent.

Now, this growth is not a bad thing in itself. It is wonderful that the services not-for-profits provide are growing. The not-for-profit organizations have more resources and more assets to serve the people who need their services.

Unfortunately, we have found that for the larger not-for-profits, including the YMCAs, over 75 percent of their revenue is coming from fees. In many cases these fees are from services that rival services that can be provided by taxpaying small businesses in this country. The problem is growing.

I an sure everyone on this panel would want me to say that none of us are against not-for-profit organizations. I serve on the board of directors of a foundation that has given over $200 million, and every penny of it went to not-for-profit organizations.

Almost everyone at this table is a member of a board of directors of a museum or a Y or a university. We think it is a wonderful thing. We are not even opposed to not-for-profit organizations going into business or engaging in commercial activities.

We welcome the competition, but we want it to be fair competition. We do not want them to be able to use their tax-exempt status to get tax-free donations, to avoid paying real estate taxes, to avoid paying income taxes on what are essentially commercial activities.

One example of how this problem is growing rather than decreasing, how certain not-for-profit organizations are reaching for even more benefits and more advantages, is an example that came up recently when a coalition of universities, museums, and nonprofit societies petitioned the IRS to make most nonprofit tour activities tax-exempt.

All of us have been contacted by a university and asked if we would like to go on a tour of Europe or a tour of the Holy Lands. The Holy Lands in my case, because I went to Notre Dame.

We know that what they are doing is they are making the same kind of profits on that kind of tour operation as a for-profit, taxpaying business. The Business Coalition for Fair Competition submitted a brief to the Internal Revenue Service objecting to this broad permission that the universities are seeking.

I respectfully request that the entire BCFC paper entitled, "Alternative Regulatory Approach," be printed in this hearing record, because it contains excellent information for Members to judge the benefits of the nonprofit appeal.

Mr. SALMON. Without objection, it is so ordered.

Mr. SCANLAN. Thank you very much.

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Is the red light on?

Mr. SALMON. Go on.

Mr. SCANLAN. One other indication of the extent to which this is a growing problem is the fact that the press throughout the United States is becoming more and more aware that this is just not a fair situation. I would like to read to you just a few quotes from the press about this.

This is from *The New York Post*: "A tax-exempt group like the YMCA has a considerable edge: exemption from Federal, State, and local income taxes; in most States exemption from sales tax; in most cities exemptions from property taxes; a 50 percent discount on postal rates; and tax-exempt financing.... For-profit ventures can help fund a not-for-profit group's charitable mission. But in some cases the ventures backfire and drain money instead."

The last quote I will read is from *The Boston Globe* about the Knights of Columbus. The Knights of Columbus is viewed as a charity by most. It is actually one of the Nation's largest insurance companies. "The Knights are one of the fastest-growing life insurance companies, consistently outperforming averages for the top 25 firms. In 1993, the Knights took in $1 billion in revenue and received top ratings from the industry's rating agency ... largely because of a $557 million surplus."

Mr. Chairman, we are very appreciative to the Committee for your willingness to listen to us today and especially to the individual representatives of companies around this table who are here to tell you about how difficult, how impossible, how many have actually been put into bankruptcy, because of the extraordinary advantages that not-for-profit organizations have in engaging in commercial activities in direct competition to small business.

Thank you.

Mr. SISISKY. Mr. Chairman, may I ask a question? I do not want to interrupt the witnesses.

Mr. SALMON. Certainly.

Mr. SISISKY. Did you say the Knights of Columbus made $1 billion from their insurance?

Mr. SCANLAN. No. I think they did $1 billion in revenues.

Mr. SISISKY. OK.

Mr. SCANLAN. They have a $500 million surplus.

Mr. SALMON. Were you thinking of changing your policy?

Mr. SCANLAN. It is a big company.

Mr. SALMON. Thank you.

We will move on now to Mr. Liberman. Thank you.

[Mr. Scanlan's statement may be found in the appendix.]

TESTIMONY OF MICHAEL LIBERMAN, PRESIDENT, VALLEY FORGE FLAG COMPANY, WOMELSDORF, PENNSYLVANIA

Mr. LIBERMAN. Thank you, Congressman. My name is Michael Liberman, and I am the president of the Valley Forge Flag Company located in Womelsdorf, Pennsylvania. I am the great grandson of an immigrant who is proud to be an American and I am proud to see his son expand the business he started to make the flags that symbolize his adopted land.

Seventy-eight years later, Valley Forge Flag is "the" flagmaker for the U.S. Government, and the history of this country is really

Valley Forge's history too. Our flags have flown on the beaches of Normandy and on the ships at Guadalcanal. It was a Valley Forge flag on the first moon flights and on the casket of President Kennedy on his final ride to Arlington Cemetery.

Today, my business is under siege from the very Government that was created to protect it. To me Valley Forge is not just a piece of real estate or a set of financial numbers. It is 400 people, working men and women, who believe like I do that we do good work at a fair price, that we have won Government contracts in competitive bidding for more than five decades because we are a good company.

Three years ago, I had to tell 50 of those people who had done nothing wrong that they no longer had jobs because the Government had taken them away. In 1993, the JWOD Committee [The Committee for Purchase from People Who Are Blind or Severely Disabled, established by the Javits-Wagner-O'Day Act] notified me that it was taking 20 percent of my core contract for over half a million burial flags given annually by the VA to the families of every American veteran, a $15 million a year contract our company has won for over 40 years.

I went to my Government to protest that the JWOD law [Javits-Wagner-O'Day Act] clearly says that in providing jobs for people with disabilities the program cannot do serious, adverse harm to the existing contractor.

The JWOD Committee, which implements this program, has decided that as long as it does not take more than 20 percent of a company's total sales there is no real harm. I suggest that if the JWOD Committee took 20 percent of Bill Gates' total sales, tomorrow the stock market would quickly give them a lesson in economics.

In the case of Valley Forge Flag, the JWOD Committee ignored cash flow, overall financial strength, debt obligations, capital commitments — and most important, 50 hard working Americans about to be out of a job.

I offered to work with the JWOD Committee. Although I already had a number of disabled workers on my payroll, I proposed a plan that would dramatically increase the number of people with disabilities being employed to perform this contract. The JWOD Committee said no.

Instead, my contract went to an outside nonprofit organization, NISH, [National Industries for the Severely Handicapped] that gets a 4 percent commission on every contract it administers for the JWOD Program in the sheltered workshops around the country which actually receive the contract.

Last year, NISH and its counterpart for the blind, NIB [National Industries for the Blind], took a whopping $7 million off the top from these Federal contracts for administrative costs, contracts totalling over $678 million a year, taken from small businesses, many like mine, who are struggling to survive. Unfortunately, some have already lost the battle.

NISH, hardly an uninterested party, was intimately involved with the JWOD Committee in determining whether the taking of the VA contract would harm Valley Forge. It is no surprise that together they decided to ignore both my protest and my proposals to

hire disabled workers, even though my plan would have employed far more disabled people under the contract than their workshops.

Instead, NISH transferred the contract to sheltered workshops who then subcontracted most of the work, we think over 90 percent, right back to a private sector company. A company which happens to be one of my biggest competitors. A company which could not win this contract in competitive bidding, but through its relationship with NISH and its satellite workshops has it now.

The outcome? For $2.6 million in sales taken from Valley Forge, eight people with disabilities got workshop jobs, far less than my proposal, while 50 working people in Pennsylvania lost theirs.

This is not how my Government should work. Yet, the JWOD people will tell you it is working just fine, even though only 21 cents of every dollar in Federal contracts taken by the JWOD Committee actually ends up as direct wages in the pockets of people with disabilities. Even though less than 10 to 15 percent of the labor required for many JWOD contracts is actually done by disabled workers.

Even though the majority of JWOD dollars end up in administrative costs, costs for materials, and in the bank accounts of for-profit contractors, — in the case of Valley Forge's contract, our estimate is that only 4 cents on the dollar went to pay the wages of people with disabilities.

The JWOD Committee also believes that under their regulation only 75 percent of the labor that a workshops decides to keep in house must be done by people with disabilities.

In fact, they told us that the JWOD Committee could set-aside a nuclear aircraft carrier, and that a NISH workshop, for example, could subcontract everything but painting the white line down the flight deck, as long as 75 percent of that line was painted by a disabled individual, they claimed, the workshop would meet the requirements of the JWOD Act. This notion not only defies Congressional intent, it defies all logic.

Even with this remarkably creative interpretation, the JWOD Committee has repeatedly criticized the workshops which received the flag contract for failing to meet even the minimum required percentage of disabled labor. This is not how my Government should work, either.

No one is against employing people with disabilities. In fact, I have 11 disabled employees right now. I am not trying to put JWOD out of business, but they should not be allowed to put me out of business, either.

Yet, despite the harm already done to my company and my employees by taking the first 20 percent of the VA contract, 2 months ago the JWOD Committee informed me it is going to take another 20 percent of the VA contract, for a total of 40 percent — a loss to Valley Forge Flag of $6 million for the fiscal 1997 contract and many million more in the years to come.

To protest this action, at my own expense I hired an independent financial expert to assess the impact of the JWOD Committee's proposed action on Valley Forge Flag. We found that taking another 20 percent of this contract would severely threaten Valley Forge's viability and likely would be a knockout blow.

Valley Forge is not Microsoft or GM. We do not have their kind of money or clout, but I believe we have right on our side. The administration of the JWOD Program is riddled with conflicts of interest. There is no oversight and no accountability.

Even the disability community itself is very critical of the way this program operates, but this is a Government program that because of its constituency has been untouchable. We all want to help people with disabilities. But make no mistake, when my employees lose their jobs, they bleed too. The Government has no right to arbitrarily take their livelihood away, even for the best of causes.

If the JWOD Committee takes this punitive action against my company this fall, I will have to lay off 50 to 70 more workers, 70 families without jobs and money to put food on the table.

If the JWOD Committee gets its way, the future of Valley Forge Flag as a company is in doubt. I don't want to be an adversary, but I feel I must be an advocate for change. My company is at stake. The future of 400 families is at stake, and I suggest to you that the ideals of fairness and opportunity upon which this country was founded are at stake too.

Thank you very much.

Mr. SALMON. Thank you, Mr. Liberman.

Mr. Hanson?

[Mr. Liberman's statement may be found in the appendix.]

TESTIMONY OF PHILIP C. HANSON, VICE PRESIDENT, THE C.H. HANSON COMPANY, DESOTO, TEXAS

Mr. HANSON. Thank you, Mr. Chairman.

My name is Philip Hanson, and I am vice president and part owner of The C.H. Hanson Company, a 130-year-old manufacturer of marking tools and safety supplies. I have been asked to speak to you today about how the JWOD [Javits-Wagner-O'Day] Program has damaged our company. I am also president of a nonprofit organization, the JWOD Reform Alliance, and represent hundreds of other companies that have been, in many cases, more adversely affected than my own.

I, like Mr. Liberman, am the great grandson of a founder of our family company. My great grandfather, Christian Hanson, stepped off the boat at Ellis Island in 1863 and immediately entered into the Union Army. Christian Hanson served our country well, was wounded in the Battle at Gettysburg, mustered out in Chicago after the war. It was here in Chicago that my great-grandfather began to build our business.

The fact is this is not the first time that our company has lost business due to the creation of Federal programs. My grandfather lobbied on a similar issue years ago when we supplied license plates and had the business taken away by the Federal Prison Industries.

During the same time, our metal stencil business was prospering and we licensed a unique invention that nobody else had, an interlocking edge. Over the years, we invested a large portion of our capital improvement dollars to perfect the technology necessary to put this edge on the stencils as efficiently as possible. Every musket, every footlocker, and tank was marked with these stencils.

Everything changed in January 1993, when I called to find out when the next solicitation was due and was told that the product was being set-aside and that our ability to make official comments had expired. After 127 years in business and faithfully supplying the Government on many contracts, our time to comment had expired without even receiving a single letter or phone call to notify us what we needed to do.

JWOD said that the business was going to be set-aside as soon for NISH [National Industries for the Severely Handicapped] as soon as a GSA facility inspection report was completed and that NISH had already approved their workshop for manufacturing even though they admitted that no equipment and no dies had even been purchased and even though the contract was to begin the very next month.

I sent a letter to the JWOD Committee explaining why this was a bad decision. GSA's purchases for stencils had been steadily declining and profit margins extremely thin. No private company would ever have made the decision to enter this business because it would be a flat out, slam dunk, bad decision. Then again, we are not talking about a private industry.

JWOD explained to me that a reversal of the decision to set the product aside could be based only upon showing a severe impact on our company and if we employed any disabled workers. JWOD said that because our Government sales were less than 15 to 20 percent of our total sales that the odds of winning a reprieve were very remote.

In 1987, the Federal Government purchased 73 percent of all the stencils the Hanson Company produced. In 1992, the Government purchased 46 percent of the all the stencils we produced. The Hanson company depended on its volume to compete with the imports from Hong Kong and in the commercial market and to expand our business.

These are sales dollars that our company, like the hundreds of others JWOD has hurt, earned with guts and sweat as a result of American free enterprise, not through a grant, loan, or an entitlement program.

After being told our chances were remote, I notified the National Association of Manufacturers, my Senators, and Congressman to solicit their help. Despite our 127 years of business, nobody could get anywhere with JWOD.

In March 1993, I contacted the largest sheltered workshop in the Illinois area and contracted with them to package the stencils for the new contract. NISH gave assurances that work would not be taken away from one workshop to give to another.

Just 2 months into the new contract, confident we had satisfied the goals of JWOD, we were notified that in spite of our critical reliance on the contract, our commitment to employ handicapped workers, the potential loss of jobs at our facility, and the assurances by NISH the contract was once again going to be set-aside. We were given 2 weeks to respond.

Desperate to keep the contract open for bid, we decided to hire a law firm to help us. We suggested entering into a teaming agreement with the workshop to show our legal commitment to having the work performed by them. NISH forbid the workshop we had

been working with from entering into this agreement. Our contact quit as a result of these games.

In spite of the enormous time constraints imposed by JWOD, I did manage to enter into a teaming agreement with a different workshop who committed to us in writing to employing full-time, 20 disabled people to perform the work.

In spite of the loss of the Government business, the Hanson Company has embarked on its most aggressive manufacturing expansion ever. We decided to open a new manufacturing plant to produce two new safety-related items.

The Government is a large customer of these items. The margins are narrow but the cash flow is good and the contract is for 2 years. Six months after we completed the plant, I found out that these products are now also being considered for set-aside under the JWOD Program.

If you think our company must be jinxed, you are right. Every time we make a move to expand our business and quote the Government, our Government has been there to make sure something goes wrong. License plates, metal stencils, flagging tape, two of these products in just the last 2½ years.

It takes years to build these product lines and attract accounts. It took the JWOD Committee one sentence in *The Federal Register* to erase the years of service we contributed to our Government. Without the cash flow generated by this Government business, the cost of our expansion has been an extreme burden. The dollars are just not there for any further expansion.

I have talked to dozens of businesses who have volumes of paperwork aimed at trying to prevent the JWOD Committee from removing the contract from private bid. Nobody is guaranteed these contracts. "These people are fighting for opportunity," to quote the business.

I have talked to everybody from landscape contractors to truck part manufacturers who were all steamrolled by JWOD. JWOD costs the Government millions of dollars in ways that can be changed in such a way that it no longer harms small business but still fulfills the goals of the people who crafted it.

The Hanson Company has tried to carve out a spot in the business world that allows us and our employees the ability to earn a dignified living. We have sent our employees to work, rationed supplies, been burned to the ground in the "Great Chicago Fire", and still managed to remain profitable every year we have been in business.

The Hanson Company has never asked the Federal Government for money or assistance, but I am asking for your attention now. Change the JWOD act and release these products back to private industry for competitive bidding on the straightforward incentive to use disabled labor. Let us let the free enterprise system remain just that.

Thank you.

Mr. SALMON. Thank you, Mr. Hanson.

Mr. Kemp?

[Mr. Hanson's statement may be found in the appendix.]

TESTIMONY OF EVAN J. KEMP, JR., EVAN KEMP AND ASSOCIATES, CAPITOL HEIGHTS, MARYLAND

Mr. KEMP. Thank you, Mr. Chairman. I appreciate this opportunity to present to the Committee a point of view which you have not heard today. It is a view which may be surprising to those of you without disabilities. Yet, in fact, what I am going to say is a position which is shared by millions of people with disabilities in this country and their families.

I have been an advocate for disability rights for over 30 years. I worked side by side with many other activists during the creation and passage of laws and regulations guaranteeing that people with disabilities have the same rights as any American. That includes the right to an education; the right to enter public buildings; the right to travel freely; the right to apply for and be considered for a job; the right to succeed; and, yes, even the right to fail.

Our years of work culminated in the signing of the Americans with Disabilities Act (ADA) on July 26, 1990. It was my privilege to sit next to President George Bush as he signed the ADA and said, "Let the shameful walls of exclusion come tumbling down." For the first time in our Nation's history, people with disabilities were granted the right, under the law of the land, to be treated without discrimination.

The ADA has empowered us to take the next step: economic independence. We are now entering the work force in increasing numbers. Employers have begun to see the wisdom of hiring people according to their ability to do the job. As we prepare to enter the 21st century, the trend is clear: people with disabilities are taking control of their own lives.

This century began quite differently. People with disabilities were excluded from nearly every segment of society. We were regarded as sick people who could not take care of themselves, either physically or economically. We were pitied by the able-bodied world. Programs were developed to take care of their needs, so that these "poor, unfortunate people" would not have to suffer so much. This is what is called the "Medical Model" — treating all disabled people as helpless patients.

The JWOD [Javits-Wagner-O'Day] Program is part of the Medical Model, originally created in 1938 to provide jobs for people who were blind. Simple, menial, underpaid jobs, but they at least provided some employment in an era when employers would not consider hiring a disabled person on his or her own merits. The program was expanded in 1971 to include all people with other physical and developmental disabilities.

Just as an aside, I graduated from law school in 1964 near the top of my class. I had 39 job interviews and 39 flat refusals. I finally sued the Federal Government, when I was denied a supervisory position.

All I would have done was supervise two people. Even though my score was 98 and the next score was 69, I did not get the job. I sued and won. In 1990, George Bush appointed me Chairman of the EEOC [Equal Employment Opportunity Commission], and I supervised 3,000 workers.

Times have changed. What began in 1938 as a well-meaning gesture now, in 1996, one of the last federally funded visages of pater-

nalism, discrimination. I am sure I would have voted for the JWOD act in 1938, but it is not needed today.

As with many other government programs, JWOD has become a bureaucracy whose real goal is to keep itself in business. One of JWOD's stated missions is to help prepare people with disabilities for competitive employment, and to provide placement services for them. Yet, the August issue of the newspaper *One Step Ahead* reports that in recent years only 6 percent of JWOD workers have moved on to competitive jobs.

In an attempt to keep itself in business, JWOD is keeping the Medical Model alive. That kind of attitude prevents people with disabilities from achieving economic independence, which is the goal of all people, disabled or not.

There is even a little upward mobility within the program. According to *One Step Ahead,* out of 25,884 workers in JWOD programs in 1995, only 189 were promoted to supervisory positions, and 2,222 received other promotions.

There are serious questions about JWOD's financial dealings. Too much of the money taken in by JWOD goes to administrative costs and not to the employees the program was created to help. Just like other programs designed to "help" minority groups, financial decisions are being made by people who are concerned with their own welfare. In JWOD's case, it is clear that able-bodied bureaucrats are filling their pockets with money that is supposed to be going to the disabled workers.

Mr. Chair, you have heard examples of JWOD's refusal to cooperate with private companies to create real jobs for disabled workers. You have heard how the JWOD industry is creating hardships for small businesses. You have heard that JWOD is not accomplishing the goals it was created to achieve and that JWOD's real goal is its own self-preservation.

I submit that JWOD in its current form has outlived its usefulness. The days of sheltered workshops should be over. The vast majority of people with disabilities can and ought to compete for jobs along with all Americans. Small business should be able to compete for Government contracts without fear of undue Government interference.

I urge you, Mr. Chairman, and all Members of Congress to take a hard and long look at JWOD and remember that people with disabilities want to be integrated into society to the best of their abilities.

In closing, I would like to say that there is a conflict between the ADA and the Medical Model. I think Congress has got to look into this and decide how these two different approaches are going to apply.

If you do not, I think you are going to bankrupt the country. Can I answer any questions that you have?

Mr. SALMON. We will hear from the entire panel and then we will have questions.

Thank you very much, Mr. Kemp.

Mr. Stack?

[Mr. Kemp's statement may be found in the appendix.]

TESTIMONY OF ROBERT P. STACK, PRESIDENT, COMMUNITY OPTIONS, BORDENTOWN, NEW JERSEY

Mr. STACK. Mr. Chairman, and members of the Committee, my name is Robert Stack, and I am the president and chief executive officer of Community Options, Inc. Community Options is a nonprofit corporation, and our mission is to develop housing and employment for persons with severe disabilities. I would like to thank this Committee for allowing me the opportunity to share with you some of our successes in placing persons with severe, multiple disabilities into regular jobs using a supported employment model. I believe it is important to state that the agenda of Community Options is basically the same agenda of any of the people we serve, any of the family members we serve, any of the members of this Committee or anyone who is proud, as we all are, to be Americans. Our agenda is one word, ladies and gentlemen, it is "work."

We fundamentally believe that everyone, regardless of the severity of their disability, who wants to work can and should work. We believe that people with disabilities have been excluded from the typical workplace through really no fault of their own.

It is not because they are sick. It is not because they are infirm. It is not because they have disabilities. It is not because they do not have the desire to work. It is because they do have the desire to work. It is because of the simple fact that a synthetic environment created with the most fundamental of good intentions was created to help protect persons with disabilities and, in fact, it prevented them from entering the work force. I am speaking specifically of sheltered workshops.

I, as a professional in the field, have to tell you that I am guilty of developing this synthetic paradigm to help people with disabilities. I did this for their well being, when all it did, by creating sheltered workshops, was foster dependence, foster exploitation, foster alienation, and segregation for all persons with disabilities, hidden behind what appeared to be professional acumen. Places like workshops, places like adult centers, places like occupational training centers, and day programs have been the old buzzwords that really dehumanize people with disabilities.

While it is convenient for the professional to hold these services as hallowed programs that advance the progress of persons with disabilities, anyone with the ability to chart and observe progress of people with disabilities will see that the majority of the persons placed in these segregated versions of disabled sweatshops never leave. These folks are rarely trained to do anything other than remain in a workshop for the rest of their lives. Many of them make as little as 25 cents an hour.

The persons generally stack and string and sort objects. They do meaningless work, and they are stuck in an environment controlled by persons who have a vested interest in them staying there with no chance of getting out. They are relegated to working in an environment segregated from persons without disabilities. They are treated with sophomoric attitudes. They are treated as though they are little children. They are not afforded the same dignity that any American should have when he or she goes to work. They are told that they are happier if they are "with their own kind".

This has been the mentality of the persons who operate those workshops, those training centers, that in fact do not train, they stifle.

To be honest with you, ladies and gentlemen, it was my mentality, until 10 years ago. It was wrong. I am very sorry because I thought I was doing the right thing, just as the staff who run workshops believe that they are doing the right thing. But they, or should I say "we," were fundamentally wrong.

The easiest way to prove that this is the case is to ask ourselves: What is the point of a workshop? What is the point of an adult training center? Well, the answer is to teach people to go to jobs.

Now, let's ask ourselves, How long have these workshops been around? Decades.

The next question is, How many people with disabilities were unemployed a decade ago? Then take note of the fact that more people are unemployed with disabilities now than ever have been in the past.

Then when you factor in how much money local, State, and Federal Governments have pumped into these workshops, it is evident to anyone that this is a lose/lose situation. It is tossing good money after bad money. It is status quo. What we have been doing is absolutely wrong. It has to stop right here and right now, with you.

As with all of the domestic problems that you, as lawmakers, are confronted with, I know that there is no simple solution. Goodness, I have no idea on what to do with child labor sweatshops or how to reduce the deficit or the welfare problem.

However, I really know how to make a significant difference in improving this situation for persons with disabilities. My point is that there are certain methods that have worked.

I would also like to add suggestions that are based on hands-on experience in dealing with persons with disabilities, people who would take Medicaid budgets and raid State coffers and local taxes, people, for example, like Harold Johnson.

Harold Johnson is a person that I met a few years ago. He was living in an institution for 50 years. He was costing the taxpayer $80,000 a year. He was blind and he was also considered profoundly mentally retarded and he was also deaf.

He would historically have been placed in a workshop. We took him out of the workshop. We placed him in a job at a Hyatt. We placed him with people without disabilities. We taught him how to fold towels. We taught him how to fold napkins. He interacts with all those people. He has been there for 3 years. He makes $7.65 an hour.

This is significant. Why? Because he is with people who do not have disabilities. People with disabilities should not be segregated in living environments because they have disabilities or to work in segregated environments because they have disabilities. We can place people with the most profound, severe disabilities in jobs.

What I ask this Committee to do, is that you consider giving incentives to businesses to hire people with disabilities in regular jobs in the community. Do not segregate them. If I had to stack and string and sort all day, I would be labeled as a behavior problem.

I ask that the Committee consider this, and I thank you for your time.

Mr. SALMON. Thank you very much, Mr. Stack.

[Mr. Stack's statement may be found in the appendix.]

TESTIMONY OF GENE MEIER, OWNER, LEWISTOWN PROPANE AND FERTILIZER, LEWISTOWN, MONTANA, REPRESENTING NATIONAL FEDERATION OF INDEPENDENT BUSINESS (NFIB)

Mr. MEIER. Mr. Chairman, members of the Committee, I would like to thank you for the opportunity to speak to you today.

Mr. SALMON. Just one second, Mr. Meier. The Members are not leaving because they're disinterested, but the little beep you heard earlier on the clock means we have 10 minutes left to vote on the House floor. Members will be coming back and forth. It's not because they're not interested in the issue. Thank you.

Mr. MEIER. My name is Gene Meier. I own and operate Lewistown Propane and Fertilizer in Lewistown, Montana. I have 12 employees and have been in business for 22 years. During that entire time, I have been a member of the National Federation of Independent Business (NFIB).

NFIB is the Nation's largest small business advocacy organization, representing more than 600,000 small and independent business owners across the United States. For more than half a century NFIB has served needs of small business on a broad spectrum of issues. NFIB sets positions on matters of public policy by regularly polling its membership.

It is fitting that I have been asked to address the Committee today regarding the matter of nonprofit competition. The biggest threat to my professional career is the unfair competition of rural cooperatives. These co-ops are tax-exempt, quasi-government entities. They pay no State or Federal income tax because they are advertised as "Customer Owned," or "Where the Customer is the Company." While they do pay some county taxes, they are only a fraction of what my company pays. A so-called "benefit" they advertise is that they are a nonprofit company. Why should a nonprofit business be allowed to compete with real, profit-oriented, taxpaying enterprises? I know I can't continue to compete on this unequal playing field.

In the county where I live, there are eight farmers' co-ops competing against me. In that same area, there are only three independent businessmen. Twenty years ago these numbers were reversed. The trend is for more nonprofits to come into being, not more businesses. With no taxes they can sell at lower prices until they are well established, and I am out of business. Twenty-two years ago when my father brought me into the business, the local Cenex Cooperative decided to take their market share in the propane business. This was followed by 5 years of below cost competition. It was not good for anyone. We barely survived. We paid very few taxes because we made little money. As soon as they gained a share, their prices rose to meet ours. My question again is how can a nonprofit company be allowed to compete?

We are a Capitalist society, co-ops are Socialists. This must change if any taxpaying, independent businesses are allowed to remain. Cooperatives are in every part of our economy. They are in

agricultural, communications, transportation, insurance, computers, groceries, convenience stores, the list goes on and on. The only thing you have to do to become a patron of a cooperative is to purchase one item. In gasoline stations, many times people do only one or two purchases and never return. I'm sure they never receive the patron's dividend.

Farmer-owned cooperatives seem to be sacred. Many have told me this could cost me my business because I'm speaking-out against the farming industry. Actually, the opposite has happened. I've had many people come into my business and express their support. They also feel if you're in business, you should pay taxes equal to everyone else in the community.

One major recommendation of the 1995 White House Conference on Small Business was to get nonprofit, non-taxed businesses out of competition with legitimate businesses. This is also a high priority of the National Federation of Independent Business. I am sure everyone is aware of the high impact of independent business in our Nation's economy. If our Government chooses to follow the agenda the National Federation of Independent Business, we will all benefit.

In closing, I don't want to destroy any business, just make it equal across the board for all businesses. I would like Congress to level the playing field. Make every business a profit-oriented, taxpaying business. If they can't compete by paying on the same tax base and running with the profit, they shouldn't be in business.

I appreciate your taking the time to hear my concerns and would be pleased to take any questions you have.

[Mr. Meier's statement may be found in the appendix.]

Mr. SALMON. Dr. Garber, I do have to vote, so I'm leaving, too. It looks like I'm going to have to have roller skates to make it. I apologize. I thought Chair Meyers would be back in time for me to vote.

We're going to have to call a brief recess. It should just be a couple of minutes. I apologize. Until the Chair returns, we are in recess.

[Recess.]

Chair MEYERS. [Presiding] The hearing will come to order.

I believe we will have our other Members back with us in just a minute or two.

Our next witness is Dr. Garber and he is president of Structure Probe, West Chester, Pennsylvania. Dr. Garber.

TESTIMONY OF CHARLES A. GARBER, PRESIDENT, STRUCTURE PROBE, WEST CHESTER, PENNSYLVANIA

Dr. GARBER. Thank you very much, Madam Chair, and I would also like to thank the Committee for holding these hearings on this most important issue.

Madam Chair, I would request that my full written statement be included in the record.

Chair MEYERS. Without objection, it will be entered into the record.

Dr. GARBER. Thank you very much. My name is Charles Garber, and I would like to say that I bring to you 26 years of business experience. And for these entire 26 years, I've had the experience of

having as my main competitors, not other businesses like my own, but nonprofit organizations, mainly universities. In many instances, some of the biggest name research universities in the United States.

Now, during the few moments that I have, I would first like to tell you what I would like to accomplish . I want to tell you a few comments about myself. I would like to tell you something about my firm. And I would also like to make it very, very clear that we are talking here not about sheltered workshops, not about all of these other different types of situations, but we are talking 100 percent about universities and certain of the Nation's most prestigious not-for-profit organizations.

Finally, I'd like to do something a little different than I've done before when I have testified on this issue in the past. Rather than saying well, this is happening, and that's happening; and then the other side says, "oh, no, no, no, we couldn't possibly be doing it." I'm going to present their own words, what they, themselves, say on the Internet, on the World Wide Web, in other words, their own advertising. I think that will speak far more eloquently as to what actually is going on than anything else I could possibly say.

I'm also proud to say that in 1980 and 1986, I was an elected delegate to the White House Conference on Small Business. For the just completed 1995 White House Conference on Small Business, I served as an appointed delegate. Through those experiences, I came to realize that this issue goes far beyond just independent laboratories and businesses like my own.

Now, about myself.

After receiving my Ph.D. in 1967, and then after spending a few years with the DuPont company, — and maybe just listening to a different drummer and being impatient — I left my secure job at DuPont in 1970. I started a business offering what is called "scanning electromicroscope services."

It came as a real surprise, if not a shock, to find out that we had a competitor down the street in Center City, Philadelphia, called the Franklin Institute. Like we heard about the Knights of Columbus and their insurance activities a few moments ago, everybody thought that Franklin Institute was something else, in this case, a science museum and a planetarium, a place to take school children. But actually, that was only 10 percent of the Franklin Institute, the other 90 percent was a big research services business.

We filed a lawsuit in 1972 in U.S. District Court in Philadelphia. Over a 5 year period, it finally ended-up in the U.S. Court of Appeals. Now, I realize this is a little bit of a oversimplification, but the Court's decision said, in essence, that we agree that there is a line that does separate what is and is not appropriate activity for nonprofit tax exempt organization. However, the tax laws are written with sufficient ambiguity that you have just not proved that they did anything wrong.

As the years went on, the National Science Foundation (NSF) took a look at this issue because they were wondering is it really right that the Nation's universities should be competing with small businesses this way? NSF issued Important Notice 91. What it basically said, because they didn't want to interfere with the legitimate research activities of any university, was that if the work was

basic and fundamental in nature, if the work was suitable for inclusion in the students' theses, and the results were for prompt publication, that would be an appropriate use of NSF-funded instrumentation.

Few of those running some of the largest NSF-funded instrumentation laboratories know about the existence of NSF Important Notice 91, since you have great difficulty even obtaining a copy of it from the NSF. Some of those who become aware of it, respond with such a level of arrogance that it's really astonishing. You can see that in some of the attachments from the Internet discussions.

Then there were some who just see the NSF-funded and other agency-funded instrumentation assets as if they were their own, to be used for their own private consulting business, and to be able to run such businesses unhindered from their university laboratories. That too is reflected in the attachments to my written statement.

To briefly summarize these attachments: Attachment Number One is from the University of Hawaii. Attachment Number Two is a firm in Florida, in reality it is a "front" through which they use the University of Miami's electron microscopy resources. Attachment Number Three contains some of the Internet postings, taken from the microscopy list server. Attachment Number Four shows the mentality of commercialization even permeates the job advertisements of certain universities. Attachment Number Six shows how even some of the universities compare prices in an effort maybe to even fix prices.

In conclusion, I would like to ask: Is it not time for Congress to take a look at the way small businesses are being squeezed out of business by the growing amount of nonprofit competition?

I thank you very much for your time.

Chair MEYERS. All right. Thank you very much, Dr. Garber. We will look at your attachments. We appreciate your bringing them with you.

Our next witness is Mr. Ralph, and he's President of Bel Air Health Club, Bel Air, Maryland. He is representing International Health, Racquet and Sportsclub Association.

[Dr. Garber's statement may be found in the appendix.]

TESTIMONY OF ROGER S. RALPH, PRESIDENT, BEL AIR HEALTH CLUB, BEL AIR, MARYLAND, REPRESENTING INTERNATIONAL HEALTH, RACQUET, AND SPORTSCLUB ASSOCIATION

Mr. RALPH. Thank you, Madam Chair, I am delighted to be here. I am speaking on behalf of IHRSA, the International Health, Racquet and Sportsclub Association, is the largest trade association of health and fitness clubs in the world. We represent some 3,000 quality health clubs serving 3.6 million consumers and 400 suppliers. Part of our mission is to help get America active, which will prove to be the most effective form of health care over the next two decades; to improve the quality of our services to our members, and to enhance our community's tax base by helping our members operate profitably.

I'm here also today, and the Committee will have a special interest in this, as a product of a Small Business Administration loan

in 1980. My wife and I were able to develop, own and operate a small racquetball club thanks to the SBA.

I'm happy to tell you that we have grown from 15 employees in 1980 to 250 employees today, from 1 acre to 8 acres, and from a few hundred members to one of the largest health club memberships in the country. Our goal is to make Bel Air Athletic Club the best community and family-oriented health club in the United States.

In partial fulfillment of that goal, we are the largest single contributor to the Harford County Sexual Assault/Spousal Abuse Center. We are also a major corporate contributor to a wonderful organization that's headquartered in Mr. Jackson's home of Chicago, the Boys and Girls Club of America, which is a nation-wide nonprofit organization which does not compete unfairly with tax paying businesses.

We have been able to grow our business for two reasons. First, we initially started with capital from the SBA through an SBA loan guarantee. Second, we have been the rare exception that has been able to successfully fight the unfair competition issue.

We were only able to do this through 6 years of work. Fifty percent of my time in the last 6 years has been spent on the fair competition issue. We've launched a significant public education campaign. Let me do a 60-second education campaign right here on what fair competition is about. It's something everybody can identify with.

Assume that you are building a $3 million health club and you started that in your neighborhood. You think it will be successful. Do you realize that if you compete against the university, a municipality, or the YMCA or a nonprofit hospital that your economic disadvantage is a half a million dollars a year. That is right, a half a million dollars a year. That means a health club of 1,500 members will have to charge $30 extra a month just to cover property taxes, income taxes, the debt service on land and buildings, which are taxes and payments which the YMCA or the nonprofit hospital or the Government agency will not have to make. That's what people are talking about in terms of a level playing field.

Our approach in Harford County, frankly, has been the exception. I wish there were thousands of examples like this. As a direct result of this public education campaign, and the formation of the Harford County Coalition For Fair Competition, we are now working with the YMCA, with our Government agencies, with the Boys and Girls Club in cooperation rather than in competition to make the best use of scarce resources.

But, frankly, our local situation is exceptional because the CEO of the YMCA of Central Maryland, Lee Jensen, is thoughtful and encourages partnerships. The National YMCA a year ago could not find a single example of a cooperative effort with the taxpaying health club sector. There's only one other example that I know, in Longfellow, MA, where a teen center has been leased by the Y on the property of a taxpaying health club, New England Health and Racquet Club.

The more common situation is right in your own back yard. You are familiar with Reston, Virginia. A wonderful concept, a new

town, very successful, and one of the richest communities in the United States.

Commissioner Robert Dix on the Fairfax County Board of Supervisors is also a member of the board of the Washington-area YMCA. Behind closed doors, Mr. Dix got Fairfax County to lease for 50 years to the YMCA for $1, 8 acres of land on the way to the Dulles Airport in Reston, Virginia. Mr. Dix never contacted any health club to determine whether in fact an alternative cooperative non-competitive arrangement could have been made to meet the social and health objectives this complex was to serve. This constructive, open-process approach was never considered, and the result is that those 20 health clubs will be hurt, and there will be no tax base built.

In the entire United States how many cities can you name that are enhancing their tax base? Our small business has paid over $1 million in income and real estate taxes. This is a proper responsibility of business. But it is very difficult to be enthusiastic about this if you're faced with unfair competition.

The problem is that nobody, including Congress, is thinking beyond "the box". The non-profit industry in this country generates $1.1 trillion in revenues annually. Do you know how much is paid in UBIT [Unrelated Business Income Tax] taxes? Less than $400 million. There's something wrong with this picture. Board members of non-profits, elected officials, taxpaying businesses need to think beyond "the box".

Let me leave you with five very specific recommendations.

The first recommendation is that the Department of the Treasury should be required to provide a public estimate of revenues lost through avoidance of UBIT.

Second, the Treasury Department should provide an official public estimate of potential new revenues to the Treasury if the UBIT law were expanded to require all commercial operations of non-profits to pay their fair share of taxes.

Third, because the law is so unclear, that law should be modified or new legislation introduced that lets the Treasury Department collect taxes that insures that all commercial activities of non-profits are taxable. They simply can't administer the law the way it is.

Fourth, the General Accounting Office (GAO) should determine the real extent of assistance to charity and needy cases by non-profits. The two biggest offenders are the YMCA and nonprofit hospitals. Sioux Falls Hospital in Sioux Valley, South Dakota, is a typical example. It had a tax exemption to run a health club facility. They claimed they were serving charitable cases. They had 2,669 memberships, only 14 were on scholarships or had their fees waived.

I submit if you ever take a look at the records of the non-profit hospital health clubs or YMCA health clubs, you'll be astounded at how low the percent of scholarships — in the case of the YMCA, I believe it's 10 percent.

The last thing that I'm urging as part of my Public Education Campaign is that Congress encourage the adoption of Fair Competition Guidelines at the Federal, State, and local level. The problem is that lots of people aren't even aware of the fair competition

issue. Broad adoption of Fair Competition Guidelines would go a long way towards educating the public.

There are these guidelines that are contained in the IHRSA publication, "The Case for Fair Competition in the Fitness Industry." In this document, there is a list of eight suggested guidelines for fair competitions. I would ask that it be included on the record.

[No response.]

The time now is to think beyond "the box" to create a win/win situation. My dream is there are thousands of Bel Air Athletic Clubs throughout the United States helping their communities, and that we work in cooperation, not in conflict, with non-profits, governments, and tax-paying business. Thank you, Madam Chair.

Chair MEYERS. Thank you very much, Mr. Ralph.

[Mr. Ralph's statement may be found in the appendix.]

Our next witness is Michael McGee. He is with National Environmental Testing, Inc., Cedar Falls, Iowa. He is representing International Association of Environmental Testing Labs. Mr. McGee.

TESTIMONY OF MICHAEL K. McGEE, NATIONAL ENVIRONMENTAL TESTING, INC., CEDAR FALLS, IOWA, REPRESENTING INTERNATIONAL ASSOCIATION OF ENVIRONMENTAL TESTING LABORATORIES

Mr. MCGEE. Thank you, Madam Chair and Members of the Committee, for the opportunity to testify. My name is Michael McGee. For the last 12 years, I've been a manager of a small commercial environmental laboratory located in Cedar Falls, Iowa, doing business in Iowa and surrounding States, such as Wisconsin.

I'm here to testify on the significant negative impacts that unfair competition from university laboratories and other tax-exempt non-profit laboratory operations have on the commercial laboratory industry.

Most commercial laboratories are, in fact, small businesses providing independent testing services for environmental compliance, public health, and product safety testing purposes. As a group, we've contributed significantly to the improvements in environmental conditions which have occurred over the last 20 years. However, with tight budgets at both the Federal and State levels, we are facing increasing competition from university and non-profit laboratories, which are looking for ways to acquire additional revenue beyond their traditional government funding sources. This comes at a time when the supply of laboratory services and resources exceeds the demand for testing services, when a large number of private laboratories have gone out of business, and many more are struggling.

The State of Iowa Hygienic Lab at the University of Iowa is a good example. They perform as much as $1.5 million a year of routine commercial testing that could be performed by private commercial labs. The same thing is happening in other States, such as Wisconsin.

In fiscal year 1994–1995, the University of Wisconsin State Laboratory of Hygiene performed $7 million of testing routinely performed by commercial labs. It is even planning to expand its operations by building a new $16.8 million laboratory. Now, neither

Iowa or Wisconsin have accounting systems in place that allow them to know what it costs to do individual tests.

As a result, they frequently underprice driving down prices in the general. For example, a 1994 Department of Natural Resources comparison of Wisconsin State Hygiene Laboratory's prices with those of three private environmental laboratories found that the State Laboratory was undercutting the private labs on price for 89 of 125 tests.

In Iowa, the same laboratory group we compete with in the marketplace is also responsible for auditing our laboratory under two — and soon to be three — separate laboratory certification programs required to perform environmental laboratory testing in the State. Certification hinges on their recommendations and approval. They are not subject to audits by other State of Iowa personnel to ensure compliance with State certification requirements. This is a clear conflict of interest.

The universities are not taking business away from private labs because they're necessarily better, faster, provide a higher level of quality, or they're more sensitive or responsive to customer needs than private laboratories. Instead, they're able to support their commercial operations through: number one, the transfer of Federal funds and contracts, subsequently used to fund commercial operations; Number two, the avoidance of sales, real estate, State and Federal income taxes; Number three, marketing the "halo effect," whereby their organization is presented as having no profit motive, which presumably "corrupts" the quality of services provided by commercial laboratory operations.

I have four basic recommendations. Number one, develop and enforce policies limiting the use of all Federal contracts and grants from supporting commercial operations of non-profit groups. For example, a university should not be able to use a testing instrument purchased under a Federal grant to compete with private commercial laboratories. For example, the instrument should be used only for the purpose of the grant and other research activities.

Number two, universities and other non-profit organizations should be required to pay income and sales taxes on profits realized through the performance of commercial work. In Iowa, my laboratory must charge a 6 percent sales tax to customers while the University of Iowa does not.

Number three, a National Laboratory Certification Program would help to remove the conflict of interest that now exists. In some States, the State laboratory is involved in certification decisions on private labs, while at the same time competing with those same laboratories in the marketplace. In that way, university laboratories would be subject to the same requirements as commercial laboratories.

A National Laboratory Certification Program would also reduce the possibility of a public laboratory engaged in commercial activity from limiting competition through the certification power.

Finally, number four, it's important to construct legislation and policy that can be enforced through the courts if need be. In Iowa, NET [National Environmental Testing, Inc.] spent 8 years and approximately a $100,000 attempting to enforce provisions of the Iowa Noncompetition By Government Act in the Iowa courts. We

lost, because the act was poorly constructed, concerned mostly with creating and preserving exemptions for the University of Iowa, rather than protecting businesses such as mine from unfair competition.

Thanks for the opportunity to testify.

Chair MEYERS. We're very glad that you were here, Mr. McGee.

Now we've given Mr. O'Brien the chance to have the very last word here. He's Chairman of Model-Star Services of Danville, Illinois and is representing Textile Rental Services Association of America.

[Mr. McGee's statement may be found in the appendix.]

TESTIMONY OF LOU O'BRIEN, CHAIRMAN, MODEL-STAR SERVICES, DANVILLE, ILLINOIS, REPRESENTING TEXTILE RENTAL SERVICES ASSOCIATION OF AMERICA

Mr. O'BRIEN. Thank you, Mrs. Meyers, and Members of the Committee. We very much appreciate this opportunity and the work that you're doing, and hope that what we talk about here today will help you in your efforts.

As noted in our written statement, we had a brush with the Danville VA Hospital. I'll skip forward, but let me say: "Members of Congress, get the VA out of the laundry business."

The VA staff, here at the Washington office, jealously guard the integrity of what they call "the world's largest laundry system." What they should tell you is "the world's worse laundry system."

It costs the taxpayers 50 percent more than if we were doing the work. They're not only inefficient, but the poor nurses in these hospitals are absolutely going through all kinds of agony because the quality and the service is so lousy. Yet, the VA laundries are run on magnificent capital equipment purchased with taxpayer dollars.

What I will now talk about is the unfair competition, which we as a company and other companies in our industry, face from the non-profit community general hospitals. Those that still retain their inefficient in-house laundry plants are increasingly going out after work other than their own. Some 40 to 60 percent of the community hospitals around the country contract their laundry work, simply because they found it to be impractical to do it in-house.

But some of those others still remain. Our company lost a bid for work at a community hospital in another county to another community hospital. Quite frankly, we still hope to make them a customer because their laundry is old; and like all the rest of them, it's costing them more to do the work in-house — using the American Hospital Association's accounting practices makes them think they're making money. Based on our estimated performance, they're losing 50 percent.

During the competition, the hospital's materials manager visited Model-Star and met our staff. He wanted us to win. Then the two hospital administrators got together. They decided to play the VHA card and felt that Decatur Memorial really ought to be doing the work. I can cite you a dozen similar cases around the country.

Well, the same thing is happening around the country with tax-exempt community general hospitals that are getting into the commercial laundry business, which is really unrelated to their core health care mission.

Now, if they have a for-profit subsidiary corporation and say, they want to build the doctors office to enhance their staffing, that's related to their mission as health care operators. But when they start getting into stuff that is wholly unrelated to their core health care mission, we think they ought to be prohibited.

Thank you very much.

[Mr. O'Brien's statement may be found in the appendix.]

Chair MEYERS. Thank you very much. We appreciate having you here. At this point, both of us will have some questions. Then I would like to ask if we keep the record open, so that other Members may submit questions in writing, and have your responses.

Your testimony here this morning, and that of the witnesses at Tuesday's hearing have made clear the unfair competition small business receives from Government, from universities, local hospitals, and other non-profits. It's very tough for small business.

Yet, we must be careful in shaping the remedies. All of us, I think, would like to make sure that universities can continue to do legitimate research and that non-profit service organizations can still carry-out their important missions.

It is a struggle to find that balance. You have helped us today.

Let me start with a question for Mr. Kemp and Mr. Stack. Others may comment as well. I will then ask Mr. Jackson if he would like to ask questions.

Mr. Kemp and Mr. Stack, the Javits-Wagner-O'Day Act community would strongly urge that many of their clients have multiple disabilities, and they require these structured social service programs? How would you respond to this?

Mr. STACK. Number one, how do you define disability? Do you want me to define it? You can't. It's very difficult.

The only term that is defined is "blindness," and that comes from — and that's peripheral vision and straight-ahead vision. Some people do OK — can't see a thing are legally — can see. Other's that have no problems seeing are legally blind. I think we'll have a very difficult time, when we start talking about "disability".

I do think the biggest barrier to disabled people, is the attitude that others have, that they can't do jobs. I think that Congress has got to decide what to do in that situation. The ADA of 1990, is going to benefit a great many disabled people.

But there are other disabled people who won't ever benefit from the civil rights secured by the ADA. The Medical Model should be followed for those people. It's a very, very tough job that you Members of Congress are in. I don't envy you. But you have got to think about the laws that you passed before and how ADA affects those laws. I would have voted for the [Javits-Wagner-O'Day Act] in 1938, gladly, but it's worthless today.

Chair MEYERS. Thank you, Mr. Stack. Mr. Kemp.

Mr. KEMP. Madam Chair, I'd just like to say that on behalf of people disabilities one thing we've realized is: "Toto," this doesn't look like Kansas anymore".

What we found is that with the right kinds of supervision and the right kinds of job coaching, you can take any person with a severe disability and put them in a job. We've been doing this all over the United States—in Denver, in Texas, in New Jersey, New York, and Pennsylvania. We found that it can work. It's just a matter of

doing the right kind of supervision. Instead of training the person in a workshop and then placing them in the job, we placed them in the job and trained them.

Certainly every lawmaker learned a lot in civics class, but they learned a lot more on the job than they did in any academic setting. The same is applicable to people with severe disabilities.

Mr. STACK I've heard all of today's talk about non-profits and competition. Community Options, which represents a lot of other agencies as well, we don't want to compete with the private sector.

Instead of setting up workshops where people with disabilities are segregated and put in segregated places, we'd like Mr. Hanson to hire people with disabilities. We'd like Mr. Meier, Mr. Ralph, and Mr. McGee and Mr. O'Brien to hire people to work in their operations alongside of people without disabilities. Because, Madam Chair, while it is true that we all work for money, and all the people in our organizations work for money, but we also work for friendships and relationships. These relationships develop where we work, for people with disabilities, just like anybody else. With the right kinds of supervision and the right kinds of support, it can, in fact, work.

Thank you.

Chair MEYERS. Thank you. Any other comments? Mr. O'Brien.

Mr. O'BRIEN. I'd just say that Model-Star, like other presenters here at the table, we also employ people who would be considered handicapped, a lot of them got good hands. We like them.

Mr. KEMP. I'd like to say one further thing. I think there's an artificial distinction between non-profit and for-profit. I have been non-profit for 8 years. I've been involved in two for-profit organizations. I think that we make too much of a distinction between the two. I think that's artificial, and I think you should look into it.

Chair MEYERS. Thank you, Mr. Kemp. The key issue with the competition from the social service programs, like the National Industries for the Severely Handicapped, seems to be what constitutes "adverse impact on the private sector".

Would any of you like to comment on this? Yes, Mr. Liberman.

Mr. LIBERMAN. Thank you, Madam Chair. "Adverse impact" would be anything that would impact a company negatively; and a severe adverse impact, obviously, is more severe than just minor adverse impact.

As an example, for our company it's part the loans we made to build our facility, its bank requirements for cash flow, and net worth. As a result of the JWOD Program, we will fall below the cash flow requirements, and we will be in default of our loans, immediately. I think that's severe adverse harm putting a company in default of its loans. That's the type of harm that we're talking about. For an individual employee, when your neighbor loses his job that may not be adverse harm to you. When you lose your job, that's severe adverse harm to any individual. I think particularly so in our industry, part of the needle trades, which has been shrinking across the United States for 40 years. My employees cannot go out and get other jobs similar to what they're doing now with the same rates of pay.

Chair MEYERS. Thank you, Mr. Hanson.

Mr. HANSON. Yes, I like to add that JWOD seems to use a 15 to 20 percent rule as to what constitutes severe harm. I would just like to point out that you can play funny numbers with percentages.

Twenty percent of $1,000, isn't a lot of money. Ten percent of $10 million is a huge amount of money. We're about a $10 million company, a very small company, it takes us years to find clients that can be developed into a million-dollar-a-year account. That's only 10 percent, that's less than half of what the JWOD Committee considers to be economically severe.

Yet, if we lost any one of our million-dollar accounts, we would suffer severe harm.

Chair MEYERS. Thank you very much.

Mr. Jackson.

Mr. JACKSON. Thank you, Madam Chair. Let me just ask a question again of Mr. Kemp, because I found your testimony to be absolutely fascinating, along with the concerns raised by Mr. Stack.

Towards a definition of "disability", what should this body consider?

Mr. KEMP. It's an extraordinarily good question you asked. I don't think you really can define it. I've been working on a definition for 30 years. I do think that the definition that we had back in 1973, which was adopted in the ADA, is probably the best.

But let me go to my own family. I come from a rather large family. We do have a disability that runs in the family, and that's dyslexia. But when I was growing up and my cousin was growing up, it wasn't recognized as a disability; and we adjusted to it.

My cousin has done extraordinarily well. I've done very, very well. None of our other relatives have done very well. But for the new group, dyslexia is now a disability.

I think that we got to get away from trying to define it; it's a total situation. That's the one thing that the ADA makes abundantly clear, that you look at the person totally and not just as a disability.

I don't think I answered your question, but I tried.

Mr. JACKSON. But I think it's close. Mr. Stack, do you want to comment?

Mr. STACK. Well, to echo Mr. Kemp, one person's disability is another person's ability.

I'm reminded of a tour that I took about 3 years ago in Galveston, Texas. I met a man that was labeled "severely cognitively impaired." He wasn't able to read, but he had very good use of his hands. He never had the ability to learn how to read.

Now, he shreds documents for Exxon, related to the *Valdez*. He makes over $8 an hour. He is friends with all the people who he's with. So, his disability has, in fact, become, Mr. Jackson, an ability.

Mr. JACKSON. Let me ask one other question of Mr. Ralph.

Mr. RALPH. Yes.

Mr. JACKSON. I got the impression that the YMCA is unfairly competing with the private sector health club industry.

I know that health, and getting in shape, is a particular interest to a lot of Americans now, particularly after several surgeon generals have worked very hard to make preventive kinds of medicine important to the average American.

I know this to be the case, because my wife is a health club fanatic. While I wish I could be, this institution here demands that we spend more time here than at a health club.

The reason I raise this question is because it appears to me that the YMCA, prior to the health craze sweeping across this Nation, had an interest as a 501(c)(3) in the preservation of health, long before the private sector even considered health to be profitable or lucrative.

In 1996, however, I would imagine that the size of the YMCA could possibly compete with the private industry now that it seeks a profit in this particular area.

Is it unfair if you will, and I don't ask the question with any hostility in this context that suggests that a 501(c)(3), like the YMCA, is unduly offering an unfair amount of competition to those of you who are in the private sector, when they simply had an interest in that area prior to the private sector.

Mr. RALPH. I think it's a terrific question and the context is important because you're dealing now with the realities of 1996 and not the realities of 30 years ago. There is a $7.2 billion health club industry out there. The Y is the single largest charity in the United States at $1.9 billion. I suspect if you look at their accounting records, they do not pay any taxes.

There are many YMCAs that run operations that do not compete with taxpaying health clubs and should not pay taxes. However, a conscious part of the YMCA's national strategy is to erect health clubs in upper and upper-middle income areas, which directly compete with the private sector. What this does is inhibit the growth of the tax-paying health club industry on the one hand, and on the other, raises serious questions about the appropriateness of some Ys, primary focus, given the social needs of our times.

My contention would be that the country is better off if the Y, where it's engaging in clearly commercial operations and taking market share from taxpaying businesses, actually paid taxes. That should be true, it seems to me, of all those non-profits when they engage in commercial activities. Beyond that, Ys everywhere should be encouraged to ensure that their primary focus is on meeting needs that are truly charitable in nature and cannot be met via the marketplace.

What we said in our recommendation, and what really is doable in 1996, is to take a look at those circumstances when organizations like the Y should pay taxes.

I am a former YMCA employee and a supporter of the YMCA. I'm just saying that they've lost a sense of what their appropriate mission and strategy is for the reality of 1996. I can't, for example, imagine that you would be supportive of building a YMCA that pays no taxes in a community like Reston, Virginia, inhibiting the private sector from perhaps doing a better job, while building that community's tax base and the Nation's tax base. There just needs to be a fresh look, I think.

Does that respond to your question?

Mr. JACKSON. Back to the issue of disability for just a moment, if I may. About 3 weeks ago, here on Capitol Hill from 7:30 in the morning until about 11 at night, I served my country for quite a few hours that day. Having determined that I was kind of tired of

serving my country and the last bells went off saying that we can go home — I kind of feel like we're in elementary school, by the way, with these bells going off around here — I decided to go out in front of the Capitol to catch a taxi to take me home. I live about 15 minutes away from Capitol Hill. Seventeen taxis passed me by from 11 in the evening until 1:30 in the morning.

I thought about that. I thought about it in the context of your testimony, Mr. Kemp. While there are certain jobs that we would say those who are physically challenged can and cannot do, I thought about my physical challenge in this society as a young African-American male, who's a Member of Congress. But taxi drivers that drive pass you, don't see "Member of Congress." They see someone that could potentially jump out of their cab and not pay them, or someone who could hold them up.

You know toward a definition of disability, there are a whole host of other "isms". I'm sure there are businesses who wouldn't consider me, as a young African-American lawyer, as the general counsel of their firm, or wouldn't consider some of my colleagues as accountants for them.

This institution is challenged to make room and seek definitions that create fairness and equality in the marketplace for all of us who have been physically, if you will, disabled.

So I'm just grateful for all of your testimony, and I'm honored to be a member of this Committee. I want to thank the gentle Chair for having the wisdom and the insight for calling today's Committee hearing.

Thank you.

Mr. KEMP. I'd like to answer, again, your question on disability.

Your father and I appeared on the Charlie Rose Show. I'm a great admirer of your father. I'm also a great admirer of Clarence Thomas. I think in a funny sort of way, that they're very similar. That if they ever got together, they would like each other very much. I really firmly believe that. I think they're very strong individuals. I think we must get away from stereotyping people and look at the individual. That's what the ADA calls for, I think that's what society calls for today.

Thank you.

Chair MEYERS. Thank you, Mr. Jackson. Let me conclude with a question. First let me ask unanimous consent that we leave the record of the hearing open for statements for the record until 5 p.m. on Thursday, August 8.

Let me ask Mr. Garber to comment on something that he's referred to in his statement a few times. Explain to the Members about NSF Important Notice 91.

Mr. GARBER. Thank you very much. I will try to keep what is really a long story into a very, very short form.

It was about the time of the 1980 White House Conference on Small Business, maybe a little bit before, when I received a call from a friend of mine at the University of Pennsylvania.

He said, "Chuck, have you seen this announcement from NSF?"

I said, "What announcement?"

He said, "They have a program that's going to really put you guys all out of business."

I said, "What are you talking about?"

He said, "Well, there's this program called 'The Regional Instrumentational Facilities Program.' The NSF says, in the program announcement, that with the growing cost of scientific instrumentation only the largest of companies will be able to afford it. Therefore, NSF is going to set up regional centers where people will come to have analyses performed and the "center" will serve as a regional resource. But, Chuck, isn't this exactly what Structure Probe is doing? It really sounds like they want to put you guys out of business. How could they do this?"

I said, "Well, Bob, you have to send me this document."

Well, this was before the days of fax machines so it came the next morning by courier, and sure enough this was exactly what NSF was proposing to do. They were indeed going to put firms like mine out of business.

Through our laboratory association, ACIL, we contacted NSF. It was unbelievable! The people who drafted the program announcement didn't even know there was a private laboratory industry out there. It came as a real shock to them that there would be someone like myself that would say this program was wrong. And keep in mind, these are the same people charged with setting the direction of national science policy.

Well, to make a long story very short, there was some kind of an agreement made, because the NSF people said, "no, no, no, what you are saying would never happen. This is going to be for cutting-edge instrumentation, not the mere off-the-shelf instrumentation that Structure Probe has. But just to make sure, we're going to allow being appointed to the Peer Review Panel, two small business people from your industry." And I was one of them. I was told I was the first small business person in history to ever serve on an NSF review panel!

Well, once this peer review panel, formed to evaluate proposals, it was, to me, just unbelievable. Because of the way the program announcement was worded, it almost was challenging one university to outdo the other, in terms of disclosing how much commercial work they were doing for industrial client firms.

Remember, we're not talking about work involving students in any real educational way. We're not talking about work that's basic and fundamental in nature. Or that type of work that would meet the test for inclusion in a student's thesis. No, this was virtually all 100 percent private proprietary work, secret work that becomes the private property of some sponsoring company. The only benefit, if you will, was more money in the pockets of certain faculty and staff members.

Well, some of the members of the review panel who knew why I was there, they themselves were shocked and embarrassed. Well, after all this happened, we had a meeting at NSF. There were representatives there from NSF, other Government agencies, and from the private laboratory community.

The general counsel at the time, I think he's still the same general counsel, Mr. Herz said, "Mr. Garber — " I guess he called me "Chuck" then. He said, "You've got to prove this. Where's the real hard-core documentation. You can't just be giving us 'words' and anecdotes, saying this is happening."

I really got upset. I jumped up and I said, "Mr. Herz, this is ridiculous. You people have all the proof right in your own file drawers from all these proposals that were submitted. You don't need me, a little guy, to tell you what the facts are. All you have to do is open up the drawers and look at them." Well, they did that. I guess they, too, were shocked or embarrassed.

Finally, over a period of a year, they came to the realization that something was seriously, seriously wrong. This resulted in issuing NSF Important Notice 91, in the early 1980's. It basically said, "Thou shalt not be doing these things."

However, after a few years the notice sort of got forgotten. The people who supposedly were there to be representing the small businesses point of view, became small businesses' biggest adversaries. It eventually became the best kept secret in Washington that a document such as NSF Important Notice 91 even exists.

Some of my attachments where you can see discussions on the Internet. When directors of major university instrumentation facilities said they never heard of NSF Important Notice 91, I offered to fax anybody a copy that wanted one. At last count, we faxed to about 35 persons. Keep in mind, these are people who are in charge of running some of NSF's biggest instrumentation centers. They didn't even know about it. So, NSF Important Notice 91, does indeed exist but there is no enforcement on the part of NSF. Unfortunately, it only applies to NSF-funded instrumentation.

If I had one thing to really ask in the way of a specific question, I would really wonder why is NSF not enforcing its own regulation? Why can't an NSF Important Notice 91-type document become the rules for NIH-funded instrumentation, for DOT-type instrumentation. Or any Government-funded instrumentation for that matter?

We're not talking about interfering with legitimate university programs or educational objectives. What we are talking about is interfering with individual faculty members getting more money, sometimes obscene amounts of money. That's what we're talking about. That is what is destroying the chain of small testing and analytical laboratories across the United States. It is being driven not to enhance a student's educational experience, it is not being done to enhance economic development or to create jobs. It is being driven by greed.

Mr. SCANLAN. Madam Chair, could I comment on that?

Chair MEYERS. Yes.

Mr. SCANLAN. One of the recommendations in BCFC's presentation here this morning, is that you consider making this type of limitation Government-wide. Specifically said, "Congress should prohibit any equipment or other assets obtained by nonprofits through Federal grants from being used for the production of commercial income". We'd like you to consider that.

Chair MEYERS. Well, I think this has been very interesting and productive hearing this morning. I want to thank you all very much for coming in and sharing with us. This is a day with a lot of competition in Congress, or we would have had more Members here for the entire hearing.

Do you have any final comments, Mr. Jackson.

Mr. JACKSON. No, thank you very much.

Chair MEYERS. Any last words for the good of the order? We are adjourned. Thank you.

[Whereupon, at 11:35 a.m., the Committee was adjourned, subject to the call of the Chair.]

APPENDIX

Committee on Small Business
U.S. House of Representatives

HEARING

on

Unfair Government Competition With Small Business:
Recommendations from the 1995 White House Conference on Small Business

July 16, 1996
10:00 a.m.

OPENING STATEMENT

Rep. Jan Meyers
Chair

Today, the Committee on Small Business meets to receive testimony on Unfair Government Competition with Small Business. As reflected in the statements of today's smalll business witnesses, it is a very persistent problem. It is one which has proved equally resistent to remedy. Worse yet, as we shall hear this morning, and at a follow-on hearing on Thursday, the situation is worsening rather than improving.

Small business faces unfair competition from Government despite long-held National policy of relying on the private sector to meet the Government's needs for goods and services. Since 1955, the Federal Government has had a formal policy on contracting-out, now referred to as Office of Management and Budget (OMB) Circular A-76. That policy, however, has been given little more than lip-service by the Executive agencies charged with its implementation.

Yet, study after study from the First Hoover Commission of the late 1940s to the most recent Heritage Foundation report of March, 1995, all reached the same conclusions. The policy of Government reliance on the private sector is sound and implementation should improved. Using the private sector to meet Government's needs can improve service to the public and reduce costs. Yet, our witnesses today will share examples of increased, rather than reduced, Government competition.

Why is this so? As we shall hear, government agencies at all levels are also being encouraged to be more entrepreneurial, to act like businesses. This is certainly a stated principle of the Vice President's National Performance Review, and many of its "re-invention" initiatives.

Federal agencies, with workforces that exceed their workloads, are being encouraged to sell services to other agencies, who may currently be relying on private contractors. To preserve their in-house capabilities, Federal agencies are selling their services to government agencies at the State and local level. As we shall hear, some Federal agencies are competing with private firms in marketing services to foreign governments, depriving small firms of "beachhead" overseas marketing opportunities fostered by many foreign governments.

Unfair Government competition is not confined to government markets. Federal agencies, and their state and local counterparts, are also entering the commercial marketplace.

And Government competition with private sector firms is clearly unfair competition. The entire operation of Government agencies from facilities, to equipment, to personnel, and working capital are all supported by tax dollars. Even if competitions are conducted between a Government agency and private firms for the provision of a service, the competition is still unfair. The total costs of agency performance are only infrequently, if ever, accurately captured.

Today's witnesses believe that things are likely to get worse rather than better because of the recent re-write of OMB Circular A-76. Rather than strengthening the national policy of reliance on the private sector, the re-write encourages the agencies to be more entrepreneurial.

Rather than tinkering with A-76, many in the small business community are urging a clear statutory policy on reliance on the private sector. Today's testimony contains strong statements of support for the "Freedom from Government Competition Act", introduced as H.R. 28 by Representative Duncan of Tennessee and its Senate companion, S. 1724, introduced by Senator Craig Thomas of Wyoming.

Whatever the form of the policy, it will require vigilance to have real effect. We in the Congress can provide some of that vigilance.

That is what these hearings are about.

I look forward to today's testimony.

JESSE L. JACKSON, JR
2D DISTRICT, ILLINOIS

Congress of the United States
House of Representatives
Washington, DC 20515–1302

COMMITTEES
BANKING AND FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY
SMALL BUSINESS
SUBCOMMITTEE ON GOVERNMENT PROGRAMS
SUBCOMMITTEE ON PROCUREMENT, EXPORTS, AND BUSINESS OPPORTUNITIES

STATEMENT BY
CONGRESSMAN JESSE L. JACKSON, JR.

COMMITTEE ON SMALL BUSINESS
HEARING ON UNFAIR GOVERNMENT
COMPETITION WITH SMALL BUSINESS

TUESDAY, JULY 16, 1996

THANK YOU MADAM CHAIRMAN FOR THE OPPORTUNITY TODAY TO ADDRESS AN ISSUE OF DEEP CONCERN TO MANY SMALL BUSINESSPEOPLE THROUGHOUT THE COUNTRY: COMPETITION BETWEEN SERVICES AND GOODS PROVIDED BY THE FEDERAL GOVERNMENT AND THOSE OFFERED BY THE PRIVATE SECTOR. AS AMERICANS WE KNOW AND VALUE THE ABILITY OF ENTREPRENEURS TO

312 CANNON BUILDING
WASHINGTON, DC 20515-1302
(202) 225-0773

11132 SOUTH HALSTED
CHICAGO, IL 60628
(312) 821 6000

17926 SOUTH HALSTED
HOMEWOOD, IL 60430
(708) 798 6000

USE FREE ENTERPRISE TO PROVIDE FOR THE NATION. AMERICA WAS LITERALLY BUILT UPON THE SUCCESSES OF ENTREPRENEURS.

AT THE SAME TIME, THERE ARE MANY TIMES IN OUR HISTORY WHEN OUR COUNTRY'S BEST INTERESTS WERE SERVED BECAUSE THE FEDERAL GOVERNMENT PROVIDED CERTAIN GOODS AND SERVICES OR UNDERTOOK SPECIFIC VENTURES. FOR INSTANCE, THE STEWARDSHIP OF OUR NATION'S GREAT RIVERS ENCOURAGED THE FEDERAL GOVERNMENT TO BUILD AND OPERATE HYDROELECTRIC FACILITIES WHICH RESPONSIBLY PUT NATURAL RESOURCES TO USE IN BRINGING ELECTRICITY TO MUCH OF THE NATION.

THE LIST OF GOODS AND SERVICES PROVIDED TODAY WOULD TAKF TOO LONG TO READ DURING

THIS OPENING STATEMENT, AND I FULLY RECOGNIZE THAT THE SCOPE AND DEPTH OF THOSE SERVICES IS PART OF WHY WE ARE HAVING THESE HEARINGS.

MADAM CHAIRMAN, AS WE LISTEN TO TESTIMONY OVER THE TWO DAYS OF THESE HEARINGS, I WILL FOLLOW WITH INTEREST THE PANELISTS DESCRIPTIONS OF SPECIFIC CONCERNS THEY HAVE REGARDING COMPETITION THEIR BUSINESSES AND ASSOCIATIONS FACE FROM GOVERNMENT AGENCIES. I WILL ALSO LISTEN TO HEAR HOW THESE PANELISTS ADDRESS CERTAIN CONCERNS INCLUDING BUT NOT LIMITED TO SITUATIONS WHERE FEDERAL AGENCIES ARE RESPONDING TO FUNDING SHORTFALLS BECAUSE CONGRESS HAS TOLD THEM TO BE MORE PRODUCTIVE ON LESS MONEY. ADDITIONALLY, I AM

26-158 96 – 3

DEEPLY CONCERNED THAT THERE ARE MANY SERVICES THAT ARE PROVIDED TO HELP PEOPLE WHO ARE MAKING THE DIFFICULT TRANSITION OFF OF PUBLIC ASSISTANCE. JUST LAST NIGHT A MEMBER OF MY STAFF TOOK A PHONE CALL FROM A YOUNG MOTHER FROM THE SECOND CONGRESSIONAL DISTRICT. SHE WAS DESPERATELY SEEKING DAYCARE ASSISTANCE. BECAUSE HEAD START IS LIMITED IN SCOPE AND INCREASINGLY IS LIMITED IN FUNDING, THE LOCAL HEAD START PROGRAM MAY BE UNABLE TO ADMIT HER TWO-YEAR-OLD TWINS. THIS YOUNG MOTHER WHO HAD ONCE SPENT FOUR MONTHS ON PUBLIC ASSISTANCE, NOW WORKS AND RECEIVES NO ASSISTANCE OF ANY KIND, BUT BECAUSE SHE CANNOT AFFORD PRIVATE DAYCARE, SHE HAS BEEN FORCED TO LOOK FOR WHATEVER

ASSISTANCE MAY BE AVAILABLE.

MADAM CHAIRMAN, THE FEDERAL GOVERNMENT SHOULD NOT BE IN EVERY BUSINESS, AND IT SHOULD NOT KEEP PEOPLE FROM EARNING THEIR LIVELIHOODS, BUT I ASK THAT WE WORK TOGETHER TO SUPPORT THE COMMON GOOD WHICH MOTIVATES THE GOVERNMENT TO PROVIDES THESE SERVICES AT ALL. MADAM CHAIRMAN, I THANK YOU FOR THIS TIME.

National Association of RV Parks & Campgrounds

Testimony of
Elaine Boissevain, Chairman
National Association of RV Parks & Campgrounds

before the
Small Business Committee
US House of Representatives
July 16, 1996

Thank you very much for the honor of appearing before you this morning, Madam Chairman.

I am Elaine Boissevain, owner of Highland Orchards Resort Park in North Stonington, Connecticut. The park is a commercial RV park and campground with more than 300 sites, located in the eastern part of the state. We have been in the campground business for more than 25 years.

During 1996, I am pleased to be serving as the National Chairman of the National Association of RV Parks and Campgrounds, a trade association comprising more than 3000 commercial campgrounds in every state of the union. It is in that capacity that I appear before you this morning to urge the Committee and the US Congress to take a strong stand for private enterprise and against government intrusion in our business. I am accompanied today by the association's President, David Gorin, whom you heard from earlier as he wore his hat as Chairman of the Business Coalition for Fair Competition.

I congratulate you, Madam Chairman, for your leadership of this committee and for the bold direction you are providing this morning by focusing the full committee's attention on this important issue of government competition.

I would like to use the time available to me this morning to succinctly lay before you several outstanding instances of government intrusion into our industry, each of which has or has the potential to directly harm or displace commercial businesses.

The first instance: In Payson, AZ, the US Forest Service has spent more than $3 million of federal funds to construct a 115-site campground just 2 miles from an existing commercial campground that was just beginning to earn a profit for its owner but is now close to ruin, will

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likely close and will likely fail to repay an SBA-backed bank loan. During the scoping process for the new campground, the Forest Service acknowledged that the proposed campground would compete with existing private sector businesses but proceeded to build the new facility anyway. Key officials of the Forest Service have acknowledged that the campground should not have been built. And now, the government is turning over its $3 million investment to a concession operator without any requirement that the operator invest any of his own capital or return any of the government's investment.

The second instance: In Klamath, CA, a community located along California's beautiful northern Pacific coast, the National Park Service operates a free, beach-front campground right along the highway, hosting some 300 RVS on an average spring weekend. The Park Service provides fire rings, portable restrooms, some picnic tables, security and beach access at no charge to the public. Several existing commercial campgrounds are close to going out of business and the situation has worsened since the Park Service took over this stretch of beach from the California Department of Transportation and opened it up to free overnight camping.

The third instance: The Army Corps of Engineers operates free campgrounds along the shores of many of the nation's prime lakes and rivers. In the few cases that the Corps charges camping fees, the fees are grossly under market cost and are collected for very short periods each year. When the peak season is over, fees are no longer collected and RVers and others are free to camp at will.

The fourth instance: Over the last 10 years, available campsites in the public sector have increased by more than 10% while the number of commercial campsites has decreased by a comparable amount. As below cost campgrounds serve the public on public lands, commercial, tax paying businesses are losing and the communities in which they are located also lose. And the federal tax base is eroded as well, as business shifts from private to public businesses.

The fifth instance: The US Forest Service, the National Park Service, the Army Corps of Engineers and the Bureau of Land Management are now joining together to create a multi-agency, national campground reservation system that will exclude the private sector from participation and will create a huge competitive business within the federal government. The proposed reservation system will compete directly with existing commercial campgrounds that operate their own reservation services and exclusion of the private sector puts those campgrounds located in close proximity to public land areas at great risk as the federal agencies will seek to keep campers on public land rather than referring them to existing private business.

The sixth instance: HR 2107, a bill which would permit federal land agencies to increase visitor service fees and retain a major portion of the revenue in the park in which the fee is charged, will provide new impetus for federal land managers to increase commercial-style services in order to earn greater income for retention at the local park level. Unless some limitations are placed on the use of those funds, we fear a growth in the number, size and amenities in public campgrounds operated by the federal government.

Let me be very clear on one important item. ARVC does not oppose the operation of campgrounds on public lands. Quite the opposite. We believe that public lands provide outstanding camping opportunities that should be available to all. However, in this era of shrinking budgets and fiscal conservation, we favor relying on private capital to provide campgrounds and camping on public lands rather than federal funds. We oppose using federal tax dollars and visitor fees to construct or expand campgrounds or to add utilities traditionally found in the commercial sector. With your permission, Madam Chairman, I would like to submit a copy of our full position statement on public lands and campgrounds to be a part of the record of this hearing. I think you will find that position statement to be most supportive of our public lands and limiting only in its relationship to federal funding of campgrounds.

Also, Madam Chairman, with your permission I would like to have another document describing the public sector competitive advantages and our views on how to level this playing field also entered into the record. The paper describes 18 advantages enjoyed by the federal government over the private sector and 12 proposals for how these advantages can be mitigated or overcome. I wish time would permit me to describe these advantages to you because they are considerable, but I trust you or your staff will review them to see the extent of the problem my colleagues and I face.

The campground and RV park industry is not afraid of competition and in fact we welcome it. The more quality camping locations there are, the greater the chance the industry will grow to meet the demand of quality-sensitive individuals. We seek only a fair chance to compete with other commercial businesses or, at the very least, a government which does not harm its small businesses when it acts like a poorly managed commercial enterprise.

In closing, Ms. Meyers, we encourage the committee to strongly support HR 28, the Freedom From Government Competition Act, and to develop other measures which will address this growing issue. We are concerned that entrepreneurial government, reinventing government and national performance review are simply code words and euphemisms for aggressive government competition with existing commercial industry. Government is not a business and the citizens of the US are not its customers. We are the owners of the government and we deserve fair and courteous treatment at all times. We are constituents, not customers to be catered to and won over. Let government govern and let the free enterprise system provide the economic strength needed by the United States. Please take steps to assure that government does not continue to overstep its bounds.

Thank you very much.

Attachments:

An Overview of the RV Park & Campground Industry
The National ARVC Position on Public Lands & Campgrounds
Public Sector Competitive Advantages & Suggestions for "Leveling" The Competitive Playing Field

7-16.hearings

NATIONAL ARVC

National
Association
of RV Parks &
Campgrounds

An Overview of the RV Park & Campground Industry

More than 9000 commercial RV parks and campgrounds in the US serve more than 20 million visitors annually. The industry is comprised of some 8000 open to the public facilities and an additional 1000 private, membership parks. Without exception, campgrounds and RV parks are small business in every sense of the word. Today's RV parks and campgrounds range from rustic facilities with few amenities to modern outdoor resorts with accommodations for recreational vehicles of all sizes, tent campers, and rental accommodations including basic cabins, fully furnished rental travel trailers, recreational park trailers and in some cases, housekeeping cabins. Parks range from very basic and primitive to the luxurious havens featuring golf courses and other recreational and social amenities.

The commercial industry grosses over $5 billion annually and employs approximately 60,000 people year round and an additional 60,000 on a seasonal basis. The majority of commercial RV parks and campgrounds are operated under family ownership although there is a growing presence of larger corporate ownership.

Like all industries, the RV park and campground business has undergone dramatic change since the early 1970s. The energy shortages of the '70s dramatically impacted on RV sales and led to the growth of seasonal camping where families leave their RV at a particular park for a winter or summer camping season. The growth of the baby-boomer generation and the desire of that age group to reunite with family in an environmentally and healthy environment has led to the growth of camping unit rentals that appeal to that upscale and family oriented market. Industry revenue growth has been significant since 1980 and the future seems bright for continued growth.

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NATIONAL ARVC

April, 1996

National Association of RV Parks & Campgrounds

THE NATIONAL ARVC POSITION ON PUBLIC LANDS AND CAMPGROUNDS

ARVC supports convenient and open access of appropriate areas on public lands for motorized and non-motorized recreation.

ARVC considers the public lands to be national treasurers which should remain in the public domain and which should be available for the enjoyment of all Americans and international visitors.

ARVC supports adequate federal appropriations for the preservation and protection of public lands and for the operation of these lands for tourism and recreation.

ARVC advocates the continued development and expansion of new public recreation facilities that are unique to the public domain and that are not inherently commercial services. Further, ARVC supports upgrading and protecting existing recreational facilities to assure that they remain available to the public and are adequate for intended recreation purposes. Examples of public facilities appropriate for government involvement are hiking trails, public fishing areas, trail heads, wildlife propagation, wilderness and primitive camping areas, scenic vistas and viewing areas, and archeological, historic and cultural sites.

ARVC supports the adoption and implementation of entrance and recreation fees that permits government to recover much of the cost of operating recreation areas for public use and provides for the retention of fees at the location where they are raised.

ARVC supports the awarding of concessions, permits and contracts to the private sector for the commercial operation of recreation areas that provide services to the public that are inherently commercial in nature and for which there exists a private sector industry capable of serving the needs of visitors to the public lands. Guidelines for awarding concessions are included in a paper issued by ARVC in 1994 and entitled Suggested Guidelines for Public Agencies Developing Private Sector Concession Opportunities for the Operation of Campgrounds and RV Parks.

ARVC supports the establishment of a level playing field between public land concession operators and nearby private sector, commercial enterprises.

ARVC opposes the use of public funds for the development and operation of recreational activities that are inherently commercial in nature.

ARVC opposes the construction, upgrading and/or operation of campgrounds and RV parks by federal, state or local government entities if those facilities contain amenities of the type typically found in commercial RV parks and campgrounds, regardless of whether they are to be concessioned to a commercial operator or operated by government.

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NATIONAL ARVC

National
Association
of RV Parks &
Campgrounds

PUBLIC SECTOR COMPETITIVE ADVANTAGES

Federal, state and local government enjoy the following competitive advantages in operating campgrounds:

1. Below market pricing with operational losses subsidized by general tax revenues.

2. No land costs, mortgages, leases, etc.

3. Exemptions from real estate and property taxes.

4. Frequently, exemption from charging or collection sales taxes.

5. No motivation to earn a profit (and even those systems that do motivate the park to earn a profit, are exempt from paying income taxes on the profits.)

6. Availability of year round employees who can be assigned and reassigned duties as required.

7. Prime scenic land often with access and control of river or lake frontage otherwise not available to the private sector.

8. Access to highway signage opportunities not available to the private sector or available only at very high cost.

9. Access to volunteer labor.

10. Self insurance and/or reduced liability insurance requirements.

11. Access to state government travel and tourism promotion dollars and resources.

12. Ability to function as a large company - statewide and national 800 numbers, reservation systems, detailing employees where needed, vast administrative bureaucracy.

13. Giveaway services to public - showers, dump stations, etc.

14. Access to media via public service announcements and use of recognizable public officials in ads.

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8. Public sector campgrounds should operate on a business-like basis and financial operations should be reported to the public in a manner that indicates how the facility actually performs. Financial reporting should indicate fiscal results including calculating taxes, depreciation, allocation of payroll, value of free services provided by public agencies, and other special considerations available to public agencies and not otherwise available to private sector business.

9. Campground operations on public lands should be contracted, concessioned or permitted to private sector business. If no private sector operator for a particular facility can be found, it might then be appropriate for the public sector to operate the facility, provided it is operated on the same basis as it was originally made available for private sector operation.

10. The public sector should focus its attention and resources on non-economic recreation such as the operation of trails for various recreational pursuits, wilderness facilities, wildlife propagation, public fishing areas, playing fields and picnic areas.

11. Public facilities should charge fees for all camping-related services rendered to the public. There should be appropriate fees for one time uses of dump stations, shower facilities, firewood, etc. when used by the public who are not otherwise paying overnight camping fees.

12. Public sector promotion of camping should focus on generic benefits of visiting a particular area or state. Public sector tourism promotion should be targeted to assist the private sector which produces tax revenues, creates jobs and builds economic strength.

Spring, 1995

15. Large discounts to seniors and other special groups without regard for economic impact.

16. Access to grants from corporations.

17. Ability to accept charitable donations to help cover operating costs, maintenance or capital development.

18. Ability to float bonds to raise capital.

SUGGESTIONS FOR "LEVELING" THE COMPETITIVE PLAYING FIELD

The commercial campground industry offers the following suggestions that could assist in removing some of the major unfair competitive advantages enjoyed by public agencies that operate campgrounds.

1. Prior to development of new campground facilities, or prior to the upgrading or improvement of existing camping sites, conduct an economic impact study to ascertain how the proposed development or upgrading is likely to impact on existing private sector campgrounds. The study should be published and distributed to those campgrounds in the geographic area likely to be impacted prior to final public sector decision-making.

2. Capital improvement plans should be published and distributed widely among likely effected parties.

3. Prior to new development and prior to upgrading or improvements, area wide occupancy studies should be conducted, published and discussed.

4. Public sector pricing should be keyed to market rates in the area and should at all times be comparable to private sector rates. In setting prices, facilities, amenities and special features (location, water frontage, natural scenic beauty, etc.) should be considered.

5. Public sector camping facilities should be limited to dry camping. The appropriate role of the public sector in furnishing camping to the general public should be limited to providing the public with clean and safe camping areas.

6. Citizens choosing to camp in commercial campgrounds should be accorded all privileges offered to those who choose to camp in the public sector. For example, park entrance fees could be waived for those camping in nearby private campgrounds if federal/state park campers are not required to pay entrance fees; commercial sector campers should receive the same priority for use of federal/state park facilities as those camping in the federal/state park; interpretive programs and other special events should be open to commercial sector campers, etc.

7. Naturalists, interpretive specialists and other public sector personnel should be available to provide services to commercial sector campers in commercial campgrounds.

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TESTIMONY OF

KATHERINE DE PUYDT, BOARD MEMBER

on behalf of the

NATIONAL CHILD CARE ASSOCIATION

before the

COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON PROCUREMENT, TAXATION AND TOURISM

UNITED STATES HOUSE OF REPRESENTATIVES

on

UNFAIR COMPETITION BY GOVERNMENT ENTITIES

JULY 16, 1996

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KATHERINE DE PUYDT, BOARD MEMBER
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JULY 16, 1996

Madame Chair and Members of the Committee:

My name is Katherine DePuydt and I own licensed private child care centers in Vermont and in North Carolina. Thank you for the opportunity to appear before you today on behalf of the National Child Care Association (NCCA). As small business owners, NCCA members must compete every day with child care providers which are nonprofit corporations, churches, public and private school systems, federal agencies and individuals who provide care in their homes. As a Member of the Board of Directors of NCCA, I have been asked to bring the concerns of this vital industry to the attention of this Committee.

The National Child Care Association represents private business providers of early childhood care and education in the nation; we are the largest single sector. Most of the members of NCCA are tax paying, not tax subsidized, small business proprietors of single center operations. It is important to understand that no more than seven percent of the available child care in this country is provided by the large chains. This industry cares for more than six million children each day. Our goal is to provide the best quality care in a developmentally appropriate environments with loving and nurturing staff. We have the privilege of working with parents to shape this nation's future, as has been confirmed during the debate on welfare reform. NCCA members make an indispensable contribution to the economic growth and business development of our communities and our country by allowing parents the peace of mind to pursue jobs and careers.

As employers and business owners, our role in the nation's economic health is also substantial. This industry employs over 800,000 individuals. There are close to 90,000 private, licensed child care programs in the nation generating annual revenue of $25 billion, and over forty percent of those programs are operated as profit making businesses.

Over the past twenty years, this industry has grown despite large and small assaults on our ability to remain financially viable, assaults ranging from skyrocketing liability insurance rates to obscure, costly regulatory changes. We try to focus our energies on the important task of providing affordable child care to millions of young working families, despite increasing regulatory pressures which constantly raise the cost of licensed child care.

In addition, we confront formidable competition from federal agencies which offer child care services, not only to government employees, but to private sector employees as well. We recognize the importance of providing family-friendly workplaces for government employees, but this should not be done at our expense, especially when there are viable alternatives.

Let me detail for you my personal experience in confronting such competition. Sixteen years ago, my husband and I literally built our first center in St. Albans, Vermont, a city of less than 7,500. When we started our business, we were the only teachers. Eventually our business grew to employ fifteen; currently, we have only seven employees.

In 1994, the Immigration and Naturalization Service built a new facility in St. Albans with plans to include a child care center. Since my center had provided year-round care for the children of many INS employees, this immediately cut into my pool of customers. Worse, if the INS center was not fully utilized by INS employees, fifty percent of its enrollment could come from the general public. The INS had its sights on my other customers as well. Moreover, the INS intended to contract with the YMCA -- a tax-exempt organization -- to run the child care facility.

Late in 1994, I received a call from the coordinator of the INS Child Care Board of Directors asking if I would submit a bid to operate the center. I expressed surprise in that I had thought the YMCA would run the program. The Y, after all, had been helping the board plan and design the program with that understanding. However, the board had been instructed to solicit bids. The INS coordinator told me that the Y had not expected to be forced to compete for this contract, and that it was "sweating bullets" at the thought that it would have to do so. I now believe that this "bidding process" was a complete sham.

I was given three days to submit a bid. Then I heard nothing until March, 1995, when I received a letter rejecting that bid, *despite our offering more services at a lower price than that proposed by the YMCA.*

This letter was the first communication in a lengthy series of telephone conversations and written correspondence with INS officials, federal government officials, and my Senator. I was shuffled from one office to the next. Eventually, my request for information as to how and why the contract was awarded to the

YMCA was sent back to the president of the INS Child Care Board of Directors, but I still have received no reply.

The YMCA-run child care center at the INS offices is now open. It advertises extensively to the general public. The INS provides a state-of-the-art facility, including furnishings, utilities, phones and computers. The YMCA need only supply the staff and consumable supplies. This is the stuff of any business person's dream.

No small independent business person can hope to compete in these circumstances. We risked everything to establish a successful business. After sixteen years of employing and training many people, and after sixteen years of paying taxes on every dollar of my income, I am seeing it undermined by competition from a collusion of my government and a large *tax-exempt* organization. The tax dollars I pay and the tax dollars my employees pay are being used to subsidize a program run by a subsidized organization in direct competition with my business. This situation is painful, unbelievable, and infuriating.

The YMCA advertises for the customers I serve, including federally-subsidized children. The State of Vermont made an exception in its regulations to license this center. I was led to believe I had a chance to be awarded this contract while it is obvious that the YMCA was always going to get it. The INS established its center as an independent corporation free to act at its own discretion, not required to comply with government contracting rules. I've never been told why my bid was not accepted nor why the YMCA's more expensive bid was accepted.

I do not know why the United States Government is in my business, or why the INS decided to establish a large child care center in a small town that already had quality child care available. Is this reinventing government? What is the point?

The other big government competitor for preschool care and education which we face is our nation's public school systems. The public schools have access to a captive market and convenient locations and a seemingly unending stream of taxpayer dollars. While struggling to do their primary job adequately, public schools are putting themselves into the child care business and openly boasting of their profits, proud their profits. Backed by tax dollars, they manage to be successful, even when they provide an inferior level of service. In most cases, public schools need not meet the same health and safety standards as those which are imposed on NCCA members.

Can you imagine our dismay and fear as we watch state after state initiate four-year-old kindergarten programs in their public schools? Especially when we know that it's simply a way to collect more federal money?

In all probability, three-year-old child care programs will soon be standard operating procedure in the public schools, even though many early childhood academicians and professionals question the wisdom of putting preschool children in public school environments.

Even worse, public school systems now are getting into the business of before- and after-school child care, under the guise of meeting a need for "latchkey" kids, whose parents may not be able to afford private child care. But the truth is that such programs do not serve low-income children. They solicit *our* paying customers. The National Study of Before- and After-School Programs confirms that school-age programs serve a small percentage of children -- twelve percent -- from families receiving public assistance. Only 21 percent of the children attending programs sponsored by the public schools receive free or reduced price meals.

In reality, the children served by these schools are usually fee-paying children who leave our centers. We can hardly blame parents for taking advantage of a reduced fee which they, after all, subsidize through their tax dollars. But we should criticize the public school system for not serving children who need care because their families cannot afford even the public schools' subsidized fees.

The private child care community operates in an intensely regulated environment, even to the point of being told precisely how many employees we must have. The cost of quality care is driven higher each day at the same time as we are forced to compete against unlicensed school-based programs that use our tax dollars to provide buildings, equipment, personnel and food at little or no cost to the school-age program; and these tax dollars subsidize the profit of these same programs. And we compete for the very same customers

It is important to understand the economics of child care to appreciate the seriousness of government competition. Not only is the existence of tax-paying small business child care owners threatened, but government competition has a severe negative impact on the availability of child care for all ages in a time when more, not less, is needed.

Because the cost of quality infant and toddler care is so high, centers subsidize that care through three-, four- and five-year-old programs as well as school-age extended care programs. Without the tuition fees generated by child care services for older children, the cost of infant and toddler care must necessarily rise to reflect its true cost. If private child care centers lose school age child care, new parents will not be able to afford the increased fees. Centers will close and the availability of infant/toddler care in safe, regulated, and monitored child care situations will decrease.

Two years ago, NCCA appeared before this Committee with similar complaints. In our industry, nothing has changed. In fact, the situation has deteriorated with the

increase in public schools offering three- and four-year-old kindergarten. We stand by the recommendations we made then:

> ***Equal protection for all children needs to be a national, state and local policy priority***

We are advocates of equal protection for all children. We believe that minimum health and safety standards should be applied to all child care programs. The vast majority of public school-based programs and home-based child care are not licensed.

The study "Caring for Our Children - National Health and Safety Performance Standards: Guidelines for Out-of-Home Child Care Programs," written by the American Academy of Pediatrics and the American Public Health Association, states:

> "Because standards are directed toward the protection of children, every child has a right to care that meets the standards, regardless of the child care setting in which the child is enrolled. Public and private schools, nurseries, preschools, centers, child development programs, baby-sitting centers, early childhood observation centers, small and large family-child-care homes, and all other settings where young children receive care by individuals who are not close relatives should be regulated. ... Nothing in the educational philosophy, religious orientation, or setting of an early childhood program inherently protects children from health and safety risks or provides assurance of a level of quality of child care. Any exemptions for care provided outside the family may place children at risk."

Our nation's children should be cared for in safe and healthy environments. For NCCA, equal protection of children is paramount, but the playing field should be level with respect to the regulatory environment. If we can compete fairly, we will survive and thrive, even though the public schools enjoy the advantages of reduced overhead through the use of public buildings and the exemption from paying taxes on child care fees.

> ***Non-traditional public school programs should concentrate on at-risk children as their first priority***

Through the use of tax dollars, government should encourage the public schools to concentrate their child care programs on "at risk" children first, and only when quality child care is not available in the private sector. When quality private care is available, federal dollars for these children should be available to all child care providers, regardless of whether they are tax paying businesses or tax-exempt or governmental organizations. The long-standing bias against for-profit child care is unwarranted and should be eliminated.

<u>True</u> collaboration followed by <u>true</u> partnerships must take place between the public and private early education communities

School systems should collaborate with the private early childhood community in the provision of three-, four- and five-year-old kindergartens and school-age programs. Models exist, particularly with three- and four-year-olds, which utilize the resources of the private sector to support public pre-kindergartens and school-age programs. These have the potential to be beneficial partnerships which utilize available community resources and provide a needed service. Thus far, however, this industry is skeptical because traditionally we are forced out of collaboration by the non-profit and public sectors.

Linkages must be formed for the good of the children and for preservation of early childhood care and education options

The public school system should rebuild its links to the private preschool community. Private preschools are partners in the educational process and should be treated as such. By working together, duplicative services could be eliminated and preschool curriculums could be enhanced to better equip children for school readiness, thus ensuring a smooth transition from preschools to public schools. Private child care centers should be permitted to advertise their before and after-school programs through the public schools, coordinating them with existing bus schedules.

NCCA recognizes that the public schools will always play a role in child care. Some areas of the country may have no other option for child care, or some communities may not be able to be served by the private sector for one reason or another.

Yet with proper funding, the private early childhood care and education community is likely to be able to accommodate virtually every situation where genuine need exists. We have a proud history of providing early care and education to American children and we know how to do it efficiently and effectively. But we cannot do so when we must compete with Big Brother.

Madame Chair, we need government's support, not its competition.

Business Coalition for Fair Competition

Unfair Government Competition With Small Businesses

House Committee on Small Business
July 16, 1996

Unfair Government Competition With Small Businesses

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Business Coalition for Fair Competition 1996

ACIL (Formerly the American Council of Independent Laboratories)
American Bus Association
American Society of Travel Agents
Colorado Coalition for Fair Competition
Helicopter Association International
International Association of Environmental Testing Laboratories
International Hearing Society
IHRSA The International Health, Racquet and Sportsclub Association
Management Association for Private Photogrammetric Surveyors
NARD National Association of Retail Druggists
National Association of RV Parks and Campgrounds
National Burglar and Fire Alarm Association
National Child Care Association
National Tour Association
Professional Services Council
Society of Travel Agents in Government
Small Business Legislative Council
Textile Rental Services Association
United Motorcoach Association

Unfair Government Competition With Small Businesses

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Honorable Jan Meyers
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Madame Chairman and Members of the Committee:

When the delegates to the White House Conference on Small Business (June 1995) made unfair competition by governments and nonprofits one of their top issues they had in mind the dramatic way in which the U.S. government competes unfairly with small businesses.

Of 434 issues, the following recommendation by 1,800 elected and appointed delegates was one of their top fifteen:

> Government and Nonprofit Competition
> Support fair competition: Congress should enact legislation that would prohibit agencies, tax-exempt and antitrust-exempt organizations from engaging in commercial activities in direct competition with small businesses. (NCRA #144: page 26 "Final 60 Recommendations" *Foundation for a New Century: A Report to the President and Congress*, by the White House Conference on Small Business, September 1995.)

This recommendation originated at the state level where delegates complained that a major competitor for many small businesses is the Federal government.

Accomplishments of the 104th Congress in Responding to the Fair Competition Resolution

We are grateful that the 104th Congress is considering ways in which to curtail government competition.

Freedom From Government Competition Act. Congressman John Duncan of Tennessee introduced HR 28, the Freedom From Government Competition Act which now has 47 cosponsors[1]. Similar legislation S. 1724 was introduced this Spring by Senator Craig Thomas of Wyoming and has 6 cosponsors[2]. The Senate Governmental Affairs Committee is expected to hold a hearing on S. 1724 August 1, 1996.

HR 28 and S. 1724 establish as national policy that all goods and services be procured from private sources. This legislation is the first Congressional initiative to eliminate government competition as a matter of national policy.

The Business Coalition for Fair Competition, a coalition of two dozen national associations, supports HR 28 and S. 1724 which state that government may conduct only operations that are so "inherently governmental" that the public interest requires production or performance by a Government employee. For example, the definition of "inherently" would only apply to such narrowly defined areas as specific parts of law enforcement and armed forces missions. HR 28 allows the government to do the work if "there is no private source capable of providing the good or service." In the case of commercial activities, private industry can do almost everything any government needs done.

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[1] Representatives Baker (CA), Baker (LA), Ballenger, Blute, Bryant (TN), Calvert, Canady, Coble, Cunningham, Dornan, Forbes, Geren, Goodlatte, Hancock, Hastert, Herger, Hoke, Hutchinson, Inglis, Klug, LaHood, Lightfoot, McCollum, McKeon, Packard, Porter, Quillen, Riggs, Rohrabacher, Royce, Salmon, Saxton, Schaefer, Seastrand, Sensenbrenner, Shays, Skeen, Solomon, Stearns, Stockman, Talent, Taylor (NC), Traficant, Waldholtz, Walsh, Weldon (FL), Zimmer.

[2] Senator's Simpson, Kyl, Craig, Shelby, Citron, and Gorton.

The Coalition supports the Freedom From Government Competition Act and we urge its adoption by Congress.

Competition From Goods Made By Prison Industries. We appreciate the leadership this Committee is providing in pointing the spotlight on the problem. For example, on June 27, 1996 you held a hearing on the extent to which the Federal Prison Industries are taking jobs away from private companies.

Madame Chairman, you have introduced HR 3745 which has 31 cosponsors[3] to eliminate the special preference prison goods have over goods made by private firms[4]. Similar legislation S. 1797 was introduced by Senator Carl Levin of Michigan.

The hearing before this Committee showed:

- ❒ Small businesses are losing business and jobs to prison industries.
- ❒ The Federal prison industries are expanding rapidly despite an internal "White Paper" which warned they are impacting small businesses.
- ❒ There is no reasonable justification for requiring Federal agencies to buy prison industry goods. We support your legislation to urge its adoption in this Congress.

Competition From Organizations Receiving Federal Help, Assistance and Special Advantages. Again on July 18 you will hold a hearing on how the Federal government assists and encourages tax-exempt business ventures to compete with the

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[3] Representative Ackerman, Baker (LA), Ballenger, Barcia, Barr (GA), Bartlett (MD), Calvert, Chambliss, Chrysler, Coble, Collins (GA), Cramer, Deal (GA), Ehlers, English (PA), Everett, Flanagan, Hefley, Hilleary, Hoekstra, Hostettler, Knollenberg, Linder, Manzullo, Oxley, Quillen, Salmon, Stump, Taylor (NC), and Upton.

[4] "To amend title 18, United States Code, to minimize unfair competition for Federal contracting opportunities between Federal Prison Industries and Private firms, especially small business concerns" introduced June 27, 1996 as the Federal Prison Industries Competition in Contracting Corrections Act of 1996.

private sector. In 1994 this Committee also held hearings on this subject. Your committee is a welcome harbor in the storm, one place we know will listen and assist with unfair competition nationwide.

Defense Reliance on the Private Sector. Thanks to the 104th Congress and an initiative by Congressman Duncan the Defense Authorization bill called on the Defense Department to promptly provide information on the government's commercial activities: a solid step in the right direction. Section 357 of Public Law 104-106 stated:

"The Secretary shall identify activities of the Department. . . that are carried out by employees of the Department to provide commercial-type products or services for the Department. . . (T)he Secretary shall transmit to the congressional defense committees a report on opportunities for increased use of private-sector sources to provide commercial products and services for the Department. . .includ(ing) the following. . .

- ❒ A list of activities. . .indicating, for each activity, whether the Secretary proposes to convert the performance of that activity to performance by private-sector sources, and, if not, the reasons why. . .
- ❒ An assessment of the advantages and disadvantages of using private-sector sources, rather than employees of the Department, to provide commercial products and services for the Department that are not essential to the warfighting mission of the Armed Forces.
- ❒ A specification of all legislative and regulatory impediments to converting the performance of activities identified. . .to performance by private-sector sources.
- ❒ The views of the Secretary on the desirability of terminating the applicability of OMB Circular A-76 to the Department. . .
- ❒ (C)onsult with, and seek the views of, representatives of the private sector, including organizations representing small businesses.

The passage of this measure caused the Department of Defense to issue a report titled "Improving the Combat Edge Through Outsourcing" (March 1996, 19pp+10pp of appendices).[5]

We urge that similar language be appended to other authorization and appropriations bills during this Congress.

Privatization Task Force. Also in the House, Congressman Scott Klug of Wisconsin acting as the leader of the Privatization Task Force, led in advancing three substantial privatization initiatives, narrowed from a list of a dozen recommendations submitted to the 104th Congress by President Clinton.[6]

The 104th Congress passed legislation to privatize the U.S. Enrichment Corporation, the Naval Petroleum Reserve, the Alaska Power marketing Administration and the National Helium Reserve. The sale of these Federal assets will (1) generate to the US Treasury several billion dollars and (2) will save annual costs of staffing, maintenance and operations.

This Congress has also authorized the outsourcing of forecasting functions of the National Weather Service, commercial real estate brokerage at the General Services Administration and debt collection at the Internal Revenue Service.

Still pending before this Congress is a proposal to set up a new employee stock ownership cooperative to conduct background

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[5] For the Coalition's views on the DOD Report, see page 17 of this testimony.

[6] In contrast to the progress made toward privatization of the US government, governments elsewhere have been more aggressive in turning to the private sector. For example, the Canadian government privatized their air control system. They are selling their air traffic control towers and training facilities. The Canadian air traffic controllers union actually supported privatization. The Canadian department will shrink from 19,000 to 4-5,000 and the work focus has moved from operations to setting standards and enforcing safety rules. Other countries enacting some privatization include Germany, Switzerland and Australia. See "Canada Plans To Privatize Air Control" by Craig Turner (Los Angeles Times) in The Washington Post, May 4, 1996.

investigations required by the U.S. Office of Personnel Management.[7]

This Congress is to be commended for privatizing its own barbershop and folding room operations. Congress has ended taxpayer support for the six employees and $320,000 budget of the U.S. Capitol Flag Office and thus appears to end the U.S. Congress' role as one the nation's biggest flag dealers.[8]

Federal Aviation Enterprises. Last year the Senate considered taking the Interior Department out of competition with private aerial surveying and mapping firms by selling the Federally-owned aircraft which are conducting commercial operations. There is no reasonable answer to the question: Why should the taxpayer support a Federal surveying air force when the private sector has the equipment, expertise, and experience to perform this work?

We supported that initiative and urge that selling off the Interior surveying air force be adopted by this Congress.

During the 104th Congress, the House held public hearings on the regulation of public aircraft under Public Law 103-411 (signed October 24, 1994). Based on that hearing, it is clear

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[7] Other government functions which should be considered for privatization in the future include "all facets of government's role in the transportation sector, including airports, air traffic control, highways, mass transit, and Amtrak" according to the Heritage Foundation ("How Congress Won the Budget War" by Ronald D. Utt, Ph. D, No 109, June 17, 1996, p. 5.) The Heritage Foundation also notes the "National Park Service has been highly resistant to the use of contractors to provide routine services such as entrance fee collection, janitorial work, and campground management, preferring instead to use more costly uniformed personnel to perform these services." (p.6)

[8] "If not 'the' Capitol flag office, will it fly?" by Elizabeth Lee, the Fairfax Journal, June 14, 1995, p. A1. The Legislative Branch Appropriations bill makes the flag office self-sustaining. The independent, non-profit, 34-year-old U.S. Capitol Historical Society may in the future take over the business but as of July 1996 no decision had been made. No such authority is included in the appropriations for the legislative branch. The Society states that it would take over the project if directed to do so by Congress. Opposition to the U.S. Congress acting as a flag dealer in competition with commercial flag dealers was led by the National Independent Flag Dealers Association, Dayton, Ohio.

the Executive Branch has not yet received the message from American small businesses.[9]

That hearing, Chaired by Congressman Duncan, showed the dramatic degree to which the Executive Branch is now helping state and local governments engage in unfair competition. Thanks to the 104th Congress, Congress urges the Executive Branch to privatize, contract out, and curtail its commercial activities and shrink the size of government.

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[9] During that hearing, the Business Coalition for Fair Competition recommended:

(1) All public service aircraft operators be required to comply with the same Federal Aviation Regulations as apply to the private sector. There should be no exceptions or exemptions from the Federal Acquisition Regulations (FARs). All operations, including all in which payment of any kind is involved including transfer of funds, should be covered by the same safety regulations. There should be no loophole for some forms of payment. When it comes to safety and fairness, neither loopholes nor exemptions are in the public interest.

(2) There be no exceptions to PL 103-411, such as those listed in the Advisory Circular of April 24, 1995 AC No 1-1. (The exceptions provision in the Circular are huge, including but not limited to:

> "firefighting, search and rescue, law enforcement, aeronautical research, or biological or geological resource management. . .are not exhaustive and that the exception may apply to other governmental functions as well". iv (d) p. 20145 *Federal Register.*

The Federal Aviation Administration must be directed by Congress to bring the regulations into compliance with the spirit and intent of the law: safety regulatory oversight of <u>all</u> government public aircraft. For example, the exemption provision in Chapter 3 (p. 20148) would allow public aircraft to skip the rules as long as they can show the cost of compliance would be "an undue economic burden"--another huge loophole. No such exemption is available to private firms; nor should it be. The issue is safety. To ensure safety, Congress should say "no" to all exceptions.

In that most of the "Examples" listed in the Advisory Circular do not describe functions which are inherently governmental, but instead describe operations which can be and are performed by private tax-paying operators, Congress must strictly limit the authority to grant exceptions.

(3) The 3,000 helicopters being distributed from Federal surplus to state and local governments be conveyed only on the condition that:
(a) they be used only if they meet the same safety regulations imposed on the private sector,
(b) they not be used to provide any service except law enforcement and
(c) they not be used to provide services which are or can be provided by the private sector.

We urge that this Congress prohibit the use of aircraft donated by the Federal government in commercial services already provided by small businesses.

Federal Assistance to Local Government Business Ventures. That Aviation Subcommittee hearing highlighted the fact that the Executive Branch distributes thousands of surplus aircraft to state and local governments so they can compete unfairly with local private aviation operators.[10]

Small companies which have long held government contracts are losing business to their customers: Federal, state and local governments.

This has been evident in operations such as air medical transport. Performed safely and cost-effectively in the past by the private sector, these functions are increasingly being performed by the public sector, which need not adhere to safety standards established for the private sector[11].

Military Exchanges and Commissaries vs. Private Sector. The 104th Congress turned down a dramatic invasion of local markets by the military exchanges and commissaries. Through the Defense Authorization Act for FY 1996, the Department of Defense sought to lift restrictions which have kept exchanges and commissaries from head to head competition with the nearby private sector on certain items. Had Congress agreed, retail outlets near military establishments would have lost sales of televisions, home and auto stereo systems, jewelry, sporting

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[10] In some instances, Federal agencies have used private sector aircraft operators to transport government employees, firefighting, search and rescue operations, biological and geological resource management and aerial mapping. However, as in the example of aerial mapping and photogrammetric surveying, far too often map and survey work is conducted by a substantial fleet of aircraft owned and operated by Federal agencies such as the Interior Department.

[11] The enforcement of Federal safety standards on the private sector, but not on the government sector, creates a fundamental element of unfairness: when costs are compared, the private sector has safety costs to which the government sector is exempt. These costs are substantial and give government a dramatic competitive advantage when government-sector costs are compared to private sector costs.

goods, and garden equipment. While clashes between the base and town retail operations are not new, the proposals to let the military take over sales and marketing is a dramatic invasion of markets served by small business.

Military vs. Private Management of Depots. The 104th Congress is dealing with the issue of how much depot management should be allocated to Federal employees and how much to the private sector.

Section 2469 of Title 10, US Code requires competition between private firms and public employees before depot management over $3 million is contracted to the private sector. Such cost comparisons take many months, consume extensive employee time, and the methodology tilts the advantages toward the government employee group.

Section 2466 reserves 60 percent of depot management to government employees. The barriers this section raises to reliance on the private sector do not serve the goal of privatization.[12]

The Department of Defense reports that "High quality, efficient maintenance service providers have emerged for many DoD overhaul requirements, creating a competitive private sector base from which DoD can often achieve best value. It has become apparent that private sector wartime support of some mission essential systems and components can be assured with acceptable risk."[13]

Even under the 60-40 rule, the Department of Defense reports it has only contracted out 28 percent of depot maintenance. Yet the DOD director of Acquisition Practices reports "Experience

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[12] Even the Department of Defense objects to the 60-40 rule: "The 60:40 split limits the Department's ability to manage depot maintenance in an efficient and cost-effective manner." "Improving the Combat Edge Through Outsourcing" by Department of Defense, March 1996, pp. 16.

[13] "Policy Regarding Performance of Depot-Level Maintenance and Repair" Report to Congress by Department of Defense, March 1996, pp. 61.

suggests a savings of 15 to 30%" when DOD contracts with private enterprise.[14]

We urge the 104th Congress to restrain the expansion of the non-appropriated funds operations on military bases and in particular to stop the take-over by base retail sales of products and services already offered by local small businesses.

Government Testing Laboratories. Congressman William Lipinski of Illinois introduced HR 2154, the Privatization of Environmental Testing Act, to encourage Federal agencies to rely on private testing laboratories. While the Federal government has over 800 laboratories doing routine testing, there is nothing inherently governmental about testing water, soil, air and other substances. This type of work is done by many small and moderate sized businesses and thus need not be duplicated by the Federal government.

House Defeats Andrews Amendment. On Thursday, June 27, 1996 the House voted 123-280 to defeat an amendment offered by Rep. Robert E. Andrews of New Jersey.

The Coalition opposed this amendment to the Transportation and Related Agencies Appropriations Act (HR 3675) because it would restrict contracting out commercial work to the private sector. Projects over $50,000 would be held up for cost studies.

It would have required local governments to give public employees extra job protection by insisting on cost studies which favor government continuing to do the work. On the Floor, Andrews called his amendment ". . .a truth-in-government amendment. It simply says if a local official, using Federal taxpayer dollars, if a State official using Federal taxpayer dollars, decides to lay people off the public payroll because they claim that it saves money, they have to show that it saves money."

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[14] "Outsourcing and Privatization: Generating Savings and Improving Quality in Defense" by Brad Bergmann, Director, Acquisition Practices, Department of Defense, 1996.

Among those speaking in opposition to the amendment was Rep. Duncan, author of the Freedom from Government Competition Act HR 28. Duncan said ". . .it would go very much against one of the leading recommendations of the most recent White House Conference on Small Business, which adopted as one of its main planks this statement: At the Federal, State and local levels, laws, regulations, and policies should prohibit direct government-created competition in which government organizations perform commercial services. That hits right at the heart of this amendment. This amendment goes against that leading recommendation. It would be very harmful to small business, it would be very costly to the taxpayer. . ." Others speaking in opposition included Rep. Frank Wolf, Rep. Rodney Frelinghusen, Rep. Bud Shuster, Rep. Jim Saxton and Rep. Tom Davis.

Davis called Andrews proposal ". . .an unfunded mandate; it is an economic study for every Federal highway program over $50,000. This amendment will delay projects. . .This makes it very difficult to contract out and utilize the private sector resources available."

The U.S. Forest Service: Head-to-Head Competition. When the U.S. Forest Service began a new campground in Payson, Arizona, at the Tonto National Forest, they went into business right across the highway from a for-profit small campground business. Using $3 million of taxpayers money, they went directly "in your face," despite admonishment from the Forest Service Policy Manual which discourages competition with the private sector. While the Coalition and the National Association of RV Parks and Campgrounds (ARVC) have opposed this new campground. The Forest Service has plunged ahead. The small campground business will probably be forced out of business this year.

This is an example of why A-76 does not work: the Forest Service argues that they don't have to adhere to OMB Circular A-76 except in the selection of vendors. The build-or-not-build decision is unaffected by the Circular. Establishing a government-owned campground is a policy matter not a procurement or acquisition matter, in the eye of the Federal government. There is no Federal policy or regulation forcing

the Forest Service to study the impact of their construction on small business. Nor is there any Federal rule that requires the Forest Service to listen to the appeal of any small businessperson who appeals or makes a counter proposal.

The half-dozen U.S. agencies which are now in the campground business are planning to team up with a new sales and marketing program: using an 800 number to make reservations in all public U.S. campgrounds. This 800 number scheme pits the Federal government in direct competition with private campgrounds and gives the Federal campground free 800-number marketing and reservation services which are not available to the private sector.

Furthermore, the park and campground superintendents may soon get to keep the public use fees paid by citizens at the gate. This will enable them to build bank accounts of unappropriated funds which they can use (1) to promote their campground vs. the nearby for-profit campgrounds and (2) build improvements which make the government campground more desirable than the private campground. Because there are so many public parks and campgrounds in the nation for which there are public use fees, this new development may result in tens of millions of taxpayer dollars stowed in separate bank accounts to which the Congress will have neither budget information nor control.

The trend toward keeping fees is spreading to other agencies. Unless Congress restricts this practice, more and more agencies will develop their own separate funds, making Congressional oversight of government commercial activities exceedingly difficult.

Heritage Foundation Recommends Contracting Out and Privatization. At the beginning of the 104th Congress, the Heritage Foundation issued two reports:

- ❒ Showing that Congress could cut Federal spending by $9 billion per year by contracting out routine support services to the private sector.[15]

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- ❒ Showing that Congress could save $11 billion in a single year by privatizing nine Federal activities and by eliminating various barriers to privatization established by Congress.[16]

The author was OMB Associate Director for Privatization, Privatization Office, in the Office of Management and Budget established in 1987 by President Reagan. While the original federal policy for contracting out was issued by President Eisenhower in 1955[17] little had been done to implement this policy. During the Reagan Administration an active plan was initiated with contracting out goals for each agency. After Reagan, the plan was not continued.

Clinton Administration Proposals. In 1993, Vice President Gore stated: "Every federal agency needs support services--accounting, property management, payroll processing, legal advice, and so on. Currently, most managers have little choice about where to get them; they must use what's available in house. But no manager should be confined to an agency monopoly. Nor should agencies provide services in-house unless the services can compete with those of other agencies and private companies."[18]

President Clinton proposed an ambitious list of possible privatization targets as part of the FY 1996 budget.

The Clinton Administration launched a review of OMB Circular A-76 and in March 1996 issued a new "Revised Supplemental Handbook on Performance of Commercial Activities, Circular No. A-76" by Office of Management and Budget. This

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[15] "Cutting the Deficit And Improving Services By Contracting Out" by Ron Utt, Ph D., The Heritage Foundation, March 10, 1995, 12 pp.

[16] "How To Achieve $11 Billion In Savings From Privatization in FY 1996" by Ron Utt Ph D., The Heritage Foundation, February 22, 1995, 9 pp.

[17] Bureau of the Budget Bulletin 55-4: "Federal government will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels."

[18] "Creating A Government That Works Better and Costs Less: Report of the National Performance Review" September 7, 1993.

Supplemental Handbook revises the traditional implementation of A-76 and adds new authorities and opportunities for the Executive Branch.

The Coalition reviewed the OMB draft and submitted extensive recommendations to OMB on December 15, 1995.[19] Various associations and government agencies also commented on the OMB draft.

The OMB plan neither refers to small business nor does it provide any encouragement to small businesses that there might be some improvement in the future. For example,

1. The plan allows any work that can be done by ten or fewer Federal employees to be kept in-house with no cost study necessary. The ten "FTE" rule will eliminate thousands of small businesses from competing for Federal work.

2. The plan also encourages agencies to keep "core" teams intact so the agency always has the capability of doing bigger things when more funding is available, thus ensuring that the government in-house bid has internal advocates whose job is at stake in the cost comparison process.

3. The OMB plan discourages any small business from proposing they do a government job because while the government can indefinitely delay the opening and consideration of bids, the small company has no such opportunity.

4. The OMB plan neither invites, nor gives any assurance of consideration to, proposals from small businesses. BCFC reports in our statement that agencies reject proposals from businesses today on a no-reason-is-necessary basis. Under the new OMB plan agencies are still under no obligation to give serious consideration to any proposal from a small business. Such discretionary or arbitrary consideration of proposals

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[19] Statement by the Business Coalition for Fair Competition, prepared for David C. Childs, Program Examiner, Budget Analysis and Systems Division, Office of Management and Budget, December 15, 1995, 37 pp.

from small business would be done initially by the very people whose jobs depend on keeping the work in-house.

OMB allows:

(1) Government agencies to spend up to 10 percent more than the private sector for the same work.

(2) Government agencies to do more contracting with each other (thus cutting the private firms out of bidding).

(3) Government agencies to designate certain work-groups as "core" and thereby exempt what they do from ever being contracted out. "Core" is a "new" concept which when added to "inherently governmental" gives the agencies two legitimate ways to avoid contracting out or privatizing.

(4) More government contracts go to tax-exempt nonprofits, thus bypassing reliance on the for-profit private sector including small firms.

These new OMB revisions to the A-76 system:

(1) Set government wide policy affecting hundreds of thousands of employees and $9 billion in procurement.

(2) Ensure the government pays 10 percent more than it should rather than use procurement to obtain the best value.

(3) Decrease the tax base (reliance on the private sector will increase tax revenues to Federal, state and local governments.

(4) Discourage and impede small business participation in government work well into the next century.

On the one hand the Supplemental Handbook attempts to tighten the rules on contracting out, making the cost comparison system more rigorous. But, on the other hand, the Supplemental Handbook implements a recommendation of the National Performance Review helping agencies market themselves to other agencies, thus by-passing the need to rely on the private sector.

The new program is called "Interservice Support Agreements ISSA)." For example, the Supplemental Handbook states: "In responding to interservice support requests, potential agency service providers will certify that their reimbursable cost estimates reflect the full competitive costs to the Government as defined in this Supplement." In other words, no cost comparison need occur as long as Federal managers feel the deal is "fair and reasonable" and so "certify".

Thus, agencies are encouraged to become entrepreneurial, promoting themselves to other agencies as the vendor of choice. Interior will solicit Agriculture and NASA will solicit Defense. Agencies will become humming business centers with extensive contracts with each other.

On the one hand this helps preserve the jobs of people who otherwise would be reassigned due to contracting out of Federal functions.

On the other hand this will keep agencies busy doing work that could and should be contracted out to the private sector. Either way, this new program is bad news for small business.

Further, while not discussed in the Supplemental Handbook, recently some agencies are offering to provide business services to state and local governments and to private entities. This activity has neither been authorized by Congress nor is it regulated by A-76 or accompanying documents.[20] The Coalition is alarmed by and opposed to this new development: Federal agencies acting as commercial entities for the purpose of doing work in the commercial sector.

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[20] The Department of Defense cites as its authority for selling to non-government buyers: Section 2553 of Title 10, U.S. Code. "Articles and services of industrial facilities: sale to persons outside the Department of Defense." However, this section clearly restricts the Department to "articles and services. . .that are not available from any United States commercial source." This section was obviously written for some obscure and infrequent transactions. However, it is now being abused as a sweeping open door to entrepreneurial agencies eager to sell themselves in the commercial marketplace. We urge the 104th Congress to stop any agency from creating and marketing products and services which should be procured from private companies.

Protection for Federal Employees. The new Supplemental Handbook extends "Right of First Refusal" for jobs to Federal employees and Federal support contract employees adversely affected by any decision to convert to a contract or to do business with another Federal agency. In fact, Executive Order 12933 "Non-Displacement of Qualified Workers Under Certain Contracts" (October 20, 1994) combined with the Supplemental Handbook gives "reemployment priority" and "effective placement" and payment of "reasonable costs for training and relocation" due to displacement.

The Supplemental Handbook adds "Agencies should notify employees affected as soon as possible of an impending cost comparison and keep them informed of its progress at every major milestone of the process."

The 60-40 rule provides unprecedented job protection for Federal employees in depots at the expense of the taxpayer and the small businesses which could do the work.

Therefore, Federal employees are well protected under the Executive Branch system. The cost comparison studies may take up to 36 months[21] under the Supplemental Handbook and give every opportunity for the Federal employees to make their best case. In contrast, employees in small businesses are not given 36 months notice when the Federal government, Federal prison industries, sheltered workshops, or nonprofits are going to take over their jobs. No company in the private sector does as much for its employees as the US Government when it comes to

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[21] "Cost comparison should be completed within eighteen months for a single activity (or thirty-six months for multiple activities) from the cost comparison start date, i.e. public or union notification and designation of the study team. Agencies are to provide an annual report to OMB on all cost comparisons that exceed these time frames including a description of the problems encountered, remedial actions, status and expected completion date." OMB Circular No. A-76--Revised Supplemental Handbook, March 1966, page 10.

Most private sector CEOs and managers are astounded that the government takes 18-36 months to figure out whether or not to outsource a program. In the fast-paced business world, studies of these lengths would be entirely unacceptable to most companies. In many cases, the "business opportunity" would have come and gone.

providing protection when outsourcing is being considered or implemented.

Inadequacy of Executive Branch Bookkeeping. The fact that the Supplemental Handbook offers up to 36 months for cost studies reflects the extraordinary disarray and inadequacy of the government's bookkeeping. Agencies should know and monitor their costs at all times and should know beyond a reasonable doubt the exact cost of all their commercial and inherently governmental activities. How else can they develop and publish an accurate budget each year? Does OMB allow agencies 36 months to prepare annual budgets?

In this age of computer data bases, there is no justification for failing to maintain current, accurate and complete cost-data on Federal business ventures. The 36-month study rule is a scandal, an affront to the taxpayer, and a symbol of Federal inefficiency at its worst.

Three-year studies consume staff and resources. Many agencies complained to OMB in December 1995 that the A-76 cost comparison system is awkward and cumbersome, inhibiting rather than empowering.

In fact, since the whole A-76 system is built around "cost comparisons" which exceed the depth and length of a Ph D dissertation, the system is fatally flawed.

Congress should insist that every agency keep current cost data at all times and that this data be turned over promptly to an independent audit when cost comparisons are made. Employees whose job is at stake in a cost study should never have a role in controlling or directing the study.

Freedom From Government Competition Act: Saves Money & Time. In comparison to the OMB's expensive 36-month cost-study approach (embedded in an antiquated and complicated OMB Circular A-76 procedure), the HR 28 and S. 1724 approach is far preferable: the costs and time wasted in thousands of studies need not occur. Under this legislation, the Federal policy would be to rely on the private sector. The

government would get out of certain businesses. Federal employees would manage various contracts performed by the private sector.

Agency employees would shift from being direct service providers to managers of service contracts. Federal personnel management training would shift from supervision of extensive commercial activities to management of contracts. These changes have already begun to work for the Department of Defense. Outsourcing works for the private sector. It can work for the whole Executive Branch.

Department of Defense: The Good and the Bad. The Department of Defense has a mixed record on the subject of reliance on the private sector.

On the one hand, during the recent U.S. military operations in Bosnia, the Department used private firms to provide health care, payroll, accounting, data management, supply management, logistics, transportation, security, maintenance and modernization of weapons, and management of military bases.

The Washington Post reported "The Defense Department has said it can save billions of dollars by contracting out, or 'outsourcing' a wide range of military functions. . .That way, the Pentagon reasons, it will have more money for its combat and humanitarian duties."[22]

On the other hand the Army Corps of Engineers is extensively in the campground business. The Army plans to build a hotel on Ft. Meyer to compete with the 9,110 hotel rooms already available from commercial companies in Arlington, Virginia.

On the one hand, the Chairman of the Joint Chiefs of Staff, General John M. Shalikashvili told the Senate Armed Services Committee: "We must continue to push with all energy acquisition reforms, commercial off-the-shelf opportunities,

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[22] "'Outsourcing' Goes Right to the Front" by John Mintz, The Washington Post, December 21, 1995, Business Section.

privatization, outsourcing of non-core activities, and further reductions of our infrastructure."[23] To its credit, the Department also has opposed the 60-40 rule, the defining of core on the artificial basis of workload, and the $3 million threshold before work can be contracted out.[24]

On the other hand, in its recommendations to the Office of Management and Budget, the Department reported it needs 48 months to conduct cost studies before contracting out.[25] As stated above, the Coalition is opposed to the 36-month studies as excessive and similarly we see absolutely no justification for 48 months under any circumstances. In the case of the Department of Defense, two regional military operations could be completed during a 48-month period making the results of any study obsolete.

Executive Order inspiring the entrepreneurial drive. When we investigated why so many Federal agencies are increasing their competition with the private sector, it became clear that Executive Orders from President Clinton and directions from the National Performance Review are inspiring Federal workers toward being more entrepreneurial. Agencies are justifying their new commercial drive by referring to the new Administration policy. In the new Executive Branch culture

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[23] March 5, 1996, p. 19 of statement.

[24] "Improving the Combat Edge Through Outsourcing, The Department of Defense, March 1996, p. 15-16

[25] Letter and attachment from Joshua Gotbaum, Assistant Secretary of Defense for Economic Security, to John Koskinen, Deputy Director for Management, OMB, December 15, 1996. Gotbaum states ". . .all commercial activities should be outsourced if economical or justification is required for any commercial activities retained in-house." Gotbaum unsuccessfully urged OMB to drop the "minimum conversion differential of 10 percent. . .to provide a level playing field for both public and private sectors." OMB's 10 percent rule says as long as the government employees don't cost more than 10 percent above the best bid of the private sector, the work will be kept in-house. In the case of the Department of Defense, this 10 percent could represent overspending of hundreds of millions of dollars.

In its comments to the OMB, the General Services Administration opposed the existing complicated A-76 procedure stating that "An elaborate study process merely serves as an obstacle to agencies." Dennis J. Fischer, Office of Chief Financial Officer, GSA, December 15, 1995.

they describe taxpayers as "customers" to whom they must sell a product or service.

In contrast to the work of the Congress in downsizing government, this new entrepreneurial spirit is a loophole giving Federal employees an alternative for saving their job: if their agency can win a contract for providing a service to another agency or with someone in the private sector, their work will continue. In this way, the will of the Congress to reduce government may be thwarted.

The new A-76 Handbook lets agencies name a core activity which will never be contracted out giving employees another ray of hope: if they work for the "core" of an agency they are home free. The spirit of A-76 was originally that any commercial function could be subject to contracting out or elimination. But, there are so many loopholes: three-year studies, entrepreneurial start-ups, protection of core, development of new non-appropriated funds, and multi-agency sales and marketing 800 number combines, we are more convinced than ever that the Freedom From Government Competition Act is the long run direction for this Congress and the small business community.

Today this Committee has a unique opportunity to dramatically influence unfair competition at the Federal, state and local levels, to establish a bright line between what the government sector does and the private sector does. Accomplishing these goals will earn the applause and gratitude of the delegates to the White House Conference on Small Business, the cosponsors of HR 28, and the thousands of businesses which have been frustrated for years by the extent to which the government sector unfairly takes jobs, work, and opportunities from tax-paying companies.

What Congress Should Do To Stop Unfair Government Competition.

1. Pass the Freedom From Government Competition Act.

2. Adopt a moratorium on Federal agencies selling services to each other to (A) determine the extent to which this type of procurement bypasses Federal acquisition rules (B) ensure that commercial sources are used rather than government sources.

Impose restrictions on agencies pursuing business with other agencies. The agency-to-agency contracting authority appears to bypass Federal competition and contracting rules and may encourage agencies to acquire and maintain a bigger than needed capacity so as to enhance their marketing of services to other agencies.

3. Prohibit Federal agencies from selling products and services to non-Federal entities when these products and services are available from small businesses.

4. Amend each authorization and appropriations bill requiring that (A) each agency have a plan for increasing reliance on commercial sources and (B) prohibiting the use of Federal funds to start or carry on any activity to provide commercial products and services if those products and services can be procured from private businesses through ordinary business channels.

5. Require that all government lines of business be clearly identified in Federal budget line items.

Businesses which are currently lumped together in general categories with many other activities should be split out so the Congress can see exactly what is being spent on each commercial activity.

For example, when you as a Member of Congress read the Budget, you should be able to determine amounts spent on all government printing whether done inside or contracted out.

As a Member of Congress you should be able to determine from the budget how many laboratories an agency operates, what the total cost of operation is, why the agency is doing this work, and why this work is not contracted out to the private sector. Currently, government laboratories are included in general line items such as "research and development" when little or none of the work done in the lab is R and D, but rather routine testing.

6. Impose restrictions on agencies to discourage automatically directing their contracting toward nonprofits. This practice eliminates from possible competition all for-profit companies including small businesses. Insist that the private for-profit sector be allowed to compete as sources for all government requirements.

7. In any legislation or regulation mentioning the word "small business" prohibit the inclusion of universities, nonprofit hospitals and other tax-exempt entities. In contrast, President Clinton recently issued an Executive Order in which non-profits were defined as small businesses.[26]

8. Prohibit Federal agencies from launching new business ventures.

For example, the Executive Branch is planning to launch a new 800 phone number to promote the use of and sell reservations at Federal campgrounds. This is a huge government undertaking pitting the Federal campgrounds against private sector campgrounds.

9. Establish a standard government-wide two-point test: (1) Should government get involved in this? And if "yes" (2) Should government employees or private contractors do the work?

Currently, there is little to discourage an agency from launching a line of business, using government employees, and ignoring sources in the private sector. For example, an agency which feels there should be a day care center at a particular site should not be free to promptly set one up with government funding but rather should be forced to ask the question, should the Federal government be in the day care business at all and

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[26] Executive Order 13005 of May 21, 1996 defines "Qualified small business" as "a small for-profit or not-for-profit trade or business that (1) employs a significant number of residents from the area of general economic distress; (2) has a significant physical presence in the area of general economic distress; or (3) has a direct impact on generating significant economic activity in the area of general economic distress." (Federal Register, pp. 26069-70.

should any day care be operated by anyone other than a private sector day care business?

10. Establish an Office of Privatization or other Federal entity to ensure that the subject of today's hearing is monitored and pursued daily in the Executive Branch. Other than the Chief Counsel for Advocacy, Small Business Administration, there is currently no champion for the private sector in the Executive Branch.

11. Continue the process of privatizing Federal business activities.

12. Empower the Procurement Center Representatives in each agency to apply the two-point test to each procurement. Empower the Small and Disadvantaged Business Office (SADBU) in each agency to oppose agency competition with private enterprise and to advocate reliance on small businesses.

13. Prohibit the use of aircraft operated by or donated by the Federal government to be used in commercial services already provided by small businesses.

14. Eliminate statutory restrictions which limit the authority of any Federal agency's contracting out.

15. Insist that "core" agency business activity be examined annually for contracting out and that "core" work should be identified in the budget, examined for termination or contracting out, and not be exempted from the standard two point test mentioned in 10 above.

16. Oppose as you did the Andrews Amendment any proposal to force cost studies on Federal, state, or local agencies as an impediment to contracting out or privatization.

17. Require agencies to utilize the services of local small businesses.[27]

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[27] In contrast, the General Services Administration has proposed reliance on the private sector in travel in such a way as to eliminate participation by small

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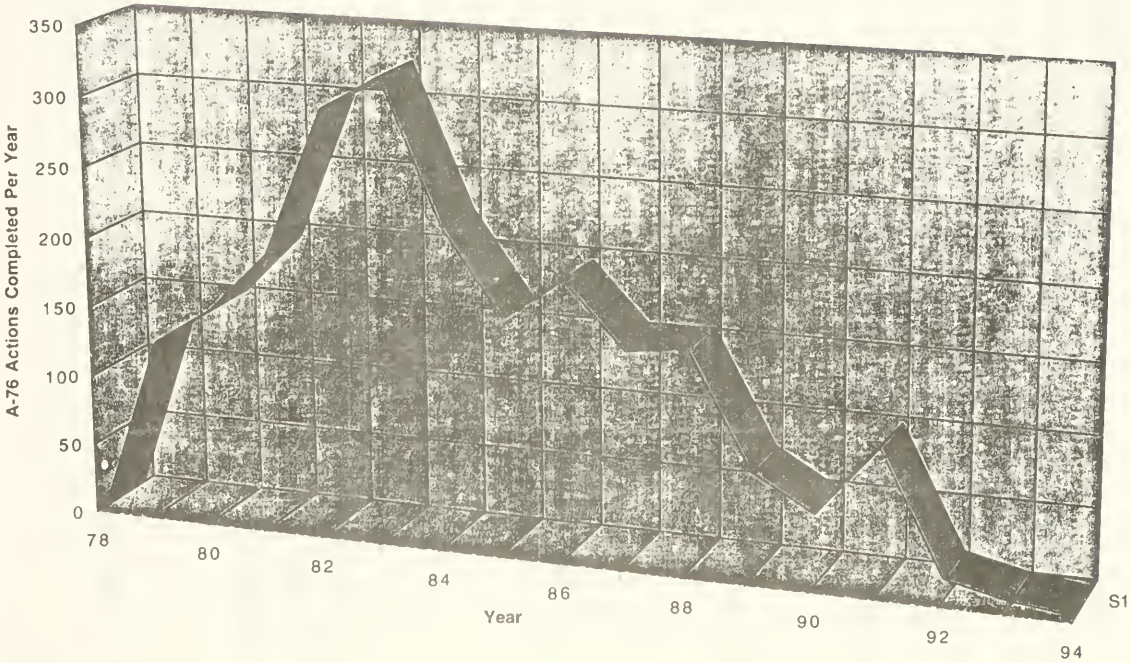
businesses. The GSA proposal was criticized April 3, 1996 by the Small Business Administration Procurement Roundtable and on May 7, 1996 by the Colorado General Support Services, Division of Central Services. The proposal to create mega travel contracts is similar to other Executive Branch proposals which "bundle" so many contracts together as to make it impossible for any small business to participate. Reliance on the private sector should recognize and respect the way the private sector competes and does business. Reliance on the private sector should not be so contrived and convoluted by government regulation as to (1) ensure failure (2) deny services to government which are available to non-government users and (3) screen out small businesses. The Executive Branch should not try to redesign the way the private sector does business but rather take advantage of it. In contrast, the GSA travel plan proposes that the private sector reorganize itself or that only certain elements of the private sector need apply. For reliance on the private sector to work, government must turn to the private sector and provide fair opportunities for small businesses to participate.

NUMBER OF DoD A-76 COMPETITIONS PER YEAR



Statement of

Molly Greene

President

General Engineering Laboratories

on behalf of

ACIL (formerly the American Council of Independent Laboratories)
and the
International Association of Environmental Testing Laboratories

Before the U.S. House of Representatives
Committee on Small Business

July 16, 1996

Thank you Madam Chairman and members of the Committee for this opportunity to testify. My name is Molly Greene. I am president of General Engineering Laboratories, an environmental testing laboratory headquartered in Charleston, South Carolina. Today, I am speaking on behalf of our industry trade associations regarding the impact government competition is having on the commercial laboratory industry. I am accompanied by Tony Pagliaro, representing one of our trade associations, and David Edelstien, from National Techical Systems, a commercial testing laboratory specialing in component and product testing for the government.

Eighty percent or more of all commercial laboratories are small businesses, providing independent testing and research for public health and product safety. Direct competition from Federal laboratories represents a sizable threat to our industry. These government laboratories are adding redundant capability -- investing in facilities, instrumentation and personnel -- to perform routine testing and analyses already offered in the private sector. Additionally, they are using government-financed equipment to compete in the bidding process with commercial laboratories.

We recognize the government's desire to maintain a core analytical capacity for essential functions such as scientific research, emergency response and high-level radioactive testing. We also recognize the need for federal laboratories to be compensated for performing the high-level scientific research that are unique to that facility. It's not the maintenance of that capability with which we take issue. Our concern is when federal facilities deviate from basic scientific missions to providing professional services that are competing with the private sector.

The Energy Department laboratories, for example, perform routine environmental monitoring and analyses.

Many times it costs the taxpayer more to perform testing in-house than to contract the work with the private sector. According to DOE statistics, more than 50 percent of the samples that could be performed more cost-effectively by the private sector are instead performed in-house.

This direct competition does limit the business of commercial laboratories in several ways. For example, by using interagency support services agreements, Federal facilities are performing testing for other government entities for a fee. Government laboratories that have excess capacity are now able to provide routine testing services to another government facility without going through competitive procurement. They bypass the traditional procurement of laboratory services from the private sector. One commercial laboratory recently reported losing a million dollar contract because of this practice.

A concern of our trade association members is the use of tax subsidized facilities to bid against our trade members for private-sector contracts. Some Federal laboratories are bidding as subcontractors to perform routine testing for commercial manufacturers. This type of testing is not unique in nature and does not require the special research capabilities for which the Federal laboratories are designed. Government laboratories even exhibit at the same client trade shows as commercial laboratories.

We have found some Federal policy to be consistent with our position but not completely effective. For example, OMB Circular A-76 states: " Federal agencies shall not provide commercial activities with the private sector." But it seems that agencies are either not aware of such policies or avoid them. The problem with Federal policy like A-76 is that it is *only* policy and *not* law. In the end, small businesses have little recourse.

We support the legislative solutions put forth by David Gorin, chairman of the Business Coalition for Fair Competition (BCFC), in his opening testimony. Until these recommendations are enacted, we ask that

government agencies abide by current Federal policy prohibiting the Federal government from competing against the private sector. We also ask that use of interagency support services agreements be immediately reviewed.

Finally, we ask the Energy Department to speedily enact its proposed "make or buy" policy for analytical services. While DOE headquarters should be commended for having drafted some good policies, we believe for these policies to be effective, they must consistently be applied throughout every DOE site.

In closing, let me simplify our concern. Is the government's position to have federally subsidized facilities perform work traditionally procured form the private sector, or do you see this as a conflict with your intentions and policies?

I thank you for the opportunity to testify.

Management Association
for Private
Photogrammetric Surveyors

Testimony of
Rick Hoffmann
Surdex Corporation
Chesterfield, MO

on behalf of the

Management Association
for Private Photogrammetric Surveyors
(MAPPS)

Before the
House Committee on Small Business

Hearing on
Unfair Government Competition

July 16, 1996

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Madam Chairman, members of the Committee, my name is Rick Hoffmann and I am President of Surdex Corp., third generation family owned professional mapping firm that has operated in St. Louis, Missouri since 1954. I am speaking today on behalf of the Management Association for Private Photogrammetric Surveyors, MAPPS, a national association of more than 100 mapping firms from throughout the United States.

Through the eyes of small business, eliminating government competition with the private sector in mapping is a little like Mark Twain's comment about the weather -- and we in Missouri know a little about Mark Twain -- he said, "everyone talks about it but nobody ever seems to do anything about it."

In 1932, a committee of the House of Representatives expressed concern over the extent to which the government engaged in activities which might be more appropriately performed by the private sector. The first and second Hoover Commissions expressed similar concern in the 1940's and recommended legislation to prohibit government competition with private enterprise. However, there was no formal policy until 1955, when Congress introduced legislation to require the Executive Branch to increase its reliance on the private sector. Final action was dropped only upon assurance from the Executive Branch that it would implement the policy administratively. Bureau of the Budget Bulletin 55-4 was issued in 1955 prohibiting agencies from carrying on any commercial activities which could be provided by the private sector. It said,

> the Federal Government will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels

In marking the 41st anniversary of this policy, it is time to recognize that President Eisenhower's policy, though still on the books today, (now found in Office of Management Budget Circular A-76) has not worked. It is time for Congress to rededicate itself to the long overdue task of enacting legislation establishing a contracting out system that works.

Each of the three White House Conferences on Small Business has made this issue one of its highest ranked.

In 1980, the first White House Conference on Small Business made unfair competition one of its top issues. It said:

> The Federal Government shall be required by statute to contract out to small business those supplies and services that the private sector can provide. The government should be compete with the private sector by accomplishing these efforts with its own or non-profit personnel and facilities.

In 1986, the second White House Conference made this one of its top three issues. It said,

> Government at all levels has failed to protect small business from damaging levels of unfair competition. At the federal, state and local levels, therefore, laws, regulations and policies should ... prohibit direct, government created competition in which government organizations perform commercial services ... New laws at all levels, particularly at the federal level, should require strict government reliance on the private sector for performance of commercial-type functions. When cost comparisons are necessary to accomplish conversion to private sector performance, laws must include provision for fair and equal cost comparisons. Funds controlled by a government entity must not be used to establish or conduct a commercial activity on U.S. property.

And last year, the 1995 White House Conference again made this a top issue. Its plank read

> Congress should enact legislation that would prohibit government agencies and tax exempt and anti-trust exempt organizations from engaging in commercial activities in direct competition with small businesses.

That was among the top 15 vote getters at the 1995 Conference and was number one among all the procurement-related issues in the final balloting.

No one has ever thought of maps as a political issue. Indeed, historically maps have seldom been controversial, save a war or two between nations or partisan squabbles during redistricting over boundaries depicted on maps. But today, one need look no further than surveying and mapping to find a major area where the Federal government has dominated, duplicated and unfairly competed with a field that can and should be left to the private sector.

MAPPS, and the private surveying and mapping profession, has good reason to be frustrated with competition from the government. Dozens of Federal agencies have in-house surveying and mapping capabilities that duplicate and are competitive with private, for-profit, tax paying entities, most of which are small businesses. Not only do these agencies perform surveying and mapping services for themselves, but they aggressively market these services to other agencies, to state and local government, and to foreign countries, in direct and unfair competition with private business.

The Clinton Administration has targeted map-making activities for increased contracting out to the private sector. This follows an initiative begun in previous Administrations of both political parties.

In the 1990 budget submitted to Congress in January, 1989, President Reagan said, "Privatization is an important management tool to raise productivity, cut costs and improve the quality of Government services." President Reagan went on to discuss the advantages of utilizing the private sector, such as "efficiency, quality and innovation in the delivery of goods and services." He concluded that "specific areas where the Government could place greater reliance on private sector providers include ... map-making activities."

What the President announced was a pilot program to take aim at surveying and mapping for OMB Circular A-76 studies. As mentioned earlier, OMB Circular A-76 is a Federal directive that requires agencies to identify "commercial activities" being performed in-house, conduct detailed comparisons of the cost of performing the function in-house with government employees versus the cost of contracting to the private sector, and contract-out the function if the private sector can perform the work for at least 10 percent less than the government.

Most heads of Federal agencies with surveying and mapping activities have refused to conduct A-76 studies on these functions. Some simply do not want to go through the burdensome process. Others claim that only the government can capably map. In truth, they all want to protect their statist empires. Since the mapping initiative was included in the FY90 budget, not a single Federal agency has conducted an A-76 review of a surveying or mapping activity.

With regard to surveying and mapping, the Clinton Administration is in agreement. In its National Performance Review, the Administration said

> The National Oceanic and Atmospheric Administration (NOAA) will experiment with a program of public-private competition to help fulfill its mission ... The experience of the U.S. Army Corps of Engineers, which contracts out 30 to 40 percent of its ocean floor charting to private firms, shows that the private sector can and will do this kind of work. Competition among private companies for these services also might reduce costs

and

> (The Administration will) issue a new order, establish a policy supporting the acquisition of goods and services in the most economical manner possible. OMB will review Circular A-76, which governs contracting out, for potential changes that would simplify the contracting process...

To be fair, it was the Federal government that gave birth to the private sector surveying and mapping industry. The Interstate Highway Act created thousands of miles of new roads and the post-war GI Bill fostered millions of housing subdivisions, generating a near insatiable demand for surveying and mapping and giving birth to hundreds of surveying and mapping companies in the 1950's. Still, the government could not resist the temptation to build its own bureaucracy to duplicate the growing private sector. In particular, the government, which relied heavily on photogrammetry (an engineering process of using precise aerial photographs to produce maps) in World War II, continued to build its in-house capability in the post-war years. This came in spite of acknowledgement of the wisdom of using the private sector.

Mapping is an activity in which the government not only fails to procure from private enterprise, but government agencies providing surveying and mapping services compete with private firms, stifle growth in private industry by dominating certain markets, divert needed technical personnel from private sector employment, thwart efforts by U.S. firms to export their services and erode the tax base by securing work that would otherwise be accomplished by tax paying entities.

The Federal government currently employs nearly 7,000 individuals in professional and technician level positions in surveying, cartography and geodesy. Most are in the Departments of Defense, Interior, Commerce and Agriculture, while others are scattered among more than 20 departments and agencies that generate or use surveying and mapping data. While most Federal agencies do not have a line item for its surveying and mapping budget and it is difficult to dissect such expenditures by activity, a conservative OMB estimate puts annual Federal spending on surveying, mapping and geodesy at $1 billion. Of that amount, only $84.7 million, or 8.5 percent could be accounted for in contracts to the private sector in fiscal year 1993.

There are more than 6,000 surveying and 250 mapping firms in the United States. These healthy, dynamic and qualified companies employ more than 40,000 persons.

It is safe to say that since 1980, private surveying and mapping firms have made a larger capital investment in plant and equipment than any other time in history. The advent of computers, electronic distance measuring instruments and satellite receivers has transformed the industry. A 1981 survey by the American Society of Photogrammetry (now the American Society for Photogrammetry and Remote Sensing) found just 33 percent of firms polled provided computer supported mapping services. In 1985 that percentage grew to 54 percent. But by 1988, a study of its members' capabilities found all MAPPS member-firms had a computer or "digital" mapping capability.

This growth and expenditure demonstrates that surveying and mapping firms have the financial resources to make significant capital investment. This speaks well for the revenue and profit potential of the industry in general. Moreover, this increase in equipment makes firms more efficient and productive.

Not only have private mapping firms made the necessary investment, but Congress has given agencies the specific ability to take advantage of these capabilities through legislation providing for the selection of firms for surveying and mapping services on the basis of "demonstrated competence and qualifications." The law (40 U.S.C. 541 et. seq., amended in the 100th Congress by Sec. 742 of PL100-656), which requires contract awards to firms who compete against one another on their demonstrated competence and qualifications and negotiation of a fee that is fair and reasonable to the government, rather than to the lowest bidder, provides Federal agencies the assurance that contractors have the capabilities, experience and qualifications to provide quality services. Use of this quality assurance process should put to rest any concern Federal agencies might have about the ability of private surveying and mapping firms to perform to the highest standards.

The ability of the private sector to provide quality professional services at a fair and reasonable price has been repeatedly demonstrated.

The U.S. Army Corps of Engineers, for example, annually contracts for 75 percent of its surveying and mapping requirements. It uses the time tested Brooks Act qualifications based selection process to choose its contractors. The Corps has high praise for the quality of the services it receives from the private sector. In testimony before a House Subcommittee in September, 1990, Mr. Herbert Kennon, Deputy Director of Civil Works, said, "Over the years, the Corps has developed working relationships with hundreds of private firms and considers them an extension of our capability."

Other military services, such as the Navy and Air Force, contract for virtually all their requirements. They, too, find the private sector highly qualified and capable of meeting the agencies' needs.

The extent of Federal competition with private surveying and mapping firms is pervasive. And the issue is not new.

In 1973 the Office of Management and Budget released a report of its Task Force on Mapping, Charting, Geodesy and Surveying. It found

> in-house mapping, charting and geodesy capabilities demand care and feeding once they are in place. And so they are fed -- in perfect conformance to the principles of Parkinson's Law.

Parkinson's Law suggests (1) the number of subordinates increases regardless of the amount of work produced; and (2) work expands so as to fill the time available for completion.

This theory has been perfectly put into practice in Federal surveying and mapping activities. Agencies have built in-house capabilities, expanded staff and completely disregarded the capabilities of the private sector. The 1973 OMB report concluded that

> private cartographic contract capability is not being used sufficiently. We found this capacity to be broad and varied and capable of rendering skilled support ... Contract capability is a viable management alternative ... Its use should be encouraged in lieu of continued in-house build-up.

That recommendation has not been even moderately implemented. In fiscal year 1972 the Federal government spent $304,761,000 on mapping, charting and geodesy activities. Of that amount, $17,051,000 or 5.5 percent was contracted to the private sector. Today only 8.5 percent is contracted. The build-up opposed in 1973 has happened. Why? Part of the reason is the reality of Parkinson's law, as stated above. Here are some examples.

The National Geodetic Survey, within the National Oceanic and Atmospheric Administration's (NOAA) National Ocean Service, conducted a competition between a private firm and its own survey "leveling" crews in Texas in 1979. The private firm proved faster (and therefore more cost effective) and more accurate than the government employees. Nevertheless, the agency does not contract with private firms.

NOAA is also responsible for producing nautical or hydrographic charts of the Great Lakes, as well as the Gulf, Atlantic and Pacific coasts. The Corps of Engineers, like NOAA, is responsible for assuring safe navigation for boats, except their venue is harbors, rivers and inland waterways. The only difference between the two is that each year the Corps awards more than 10 contracts valued at more than $10 million, NOAA has awarded just three such contracts in its 200 year history.

NOAA embarked upon a new surveying program, commonly referred to as High Accuracy Reference Network (HARN), to provide a "super network" of Global Positioning System (GPS) survey control points in various states. NOAA personnel and equipment are dispatched from Washington, DC to various States to perform this work. These projects are funded through cooperative agreements between NOAA and individual states, and in some cases the project are 100% funded by a state. In at least two instances, New York and Vermont, private firms worked with their State agencies to develop these projects. When these projects developed, NGS stepped in, took control of these projects, and performed them with government employees.

Such agreements constitute unfair government competition with private business. There are several private firms with the multi-channel, dual frequency GPS satellite receivers, as well as the personnel, experience and qualifications which NOAA claims are necessary to perform the required services.

One of our member firms in Louisiana spent months developing a mapping project with a parish or county in its home state. The firm advised the parish that it could qualify for 50% Federal funds from the U.S. Geological Survey. What happened when the firm put the parish in touch with the USGS? The GS tried to take the project away from the firm.

The USGS has an annual appropriation from Congress of about $125 million for map making. But the agency's National Mapping Division contracts for only $17 million. That is just 30% of its national map and digital data production budget and just over 10% of its total appropriation for national mapping, geography and surveys. The difference goes to reimbursable work for other Federal agencies, State and local governments, and foreign countries, and to support acquisition and maintenance of new equipment to support its in-house production effort. The additional income from reimbursable work, which would otherwise go to private firms, is a result of the agency's aggressive marketing effort.

The Federal government not only uses tax dollars to compete with private surveying and mapping firms at the Federal level, but at the State level as well.

As Congress enacted increases in the Federal gasoline tax, most of that money was apportioned back to the 50 states for highway programs. Many states used the money to build up their in-house mapping capability, purchasing aerial cameras and airplanes, computers, map plotting machines, GPS receivers and other expensive equipment that private firms already have in place.

According to the Federal Highway Administration, only 5 states spend more than $10 million per year on preliminary engineering contracts, including surveying and mapping, and only 5 contract more than $5 million.

Between 1979 and 1989, States spent an average of only 37 percent of their Federal Highway funds for preliminary engineering (including surveying and mapping). Only 23 states contracted out more than 1/3 of their preliminary engineering funds. California, for example, the largest recipient of Federal Highway funds, was at the bottom of the list in private sector utilization, contracting just $70,000 of the $54.8 million (less than 1/10th of 1 percent) of its average annual Federal funding for preliminary engineering. In some years, California did not contract out any of its Federal funding for preliminary engineering services.

The private sector in architecture, engineering, surveying and mapping is deeply concerned about the entry of a corporation created by the U.S. Bureau of Prisons (a Federal prison industry known as UNICOR) into engineering-related services, including geographic information systems (GIS) and computer aided design and drafting (CADD) services.

Specifically, UNICOR has developed a capability to provide scanning and digitizing services to other Federal agencies. According to UNICOR documents, it is "broadening its prime contractor role ... in the areas of ... digitization of maps for GIS applications, digitization of engineering and facilities management drawings (am/fm), scanning and digitizing, CALS conversions."

First, UNICOR retained PlanGraphics, Inc. a GIS consulting firm to provide assistance on defining the potential GIS market and advising the prison industry on entry into GIS services. Then, UNICOR retained Harvard Design and Mapping, Inc. to provide GIS system acquisition management. The firms will oversee UNICOR's acquisition and installation of GIS/CADD systems, including a needs analysis with hardware and software specification recommendations, integration and installation of such systems, and training of inmates in GIS/CADD digitizing and imaging skills. UNICOR has indicated it is now productive in this area, having begun providing AM/FM services for agencies of the Department of Defense.

Under Federal law, UNICOR must diversify so far as practicable so that no single private industry carries an undue burden of competition. Prior to entering an industry, the UNICOR board is required to make a report. One can hardly understand how UNICOR would not realize that entering the mapping field would not adversely affect the private sector when one considers the pervasiveness of government competition.

Other agencies, such as the Bureau of Reclamation, Forest Service, Natural Resource Conservation Service (formerly the Agricultural Stabilization and Conservation Service and the Soil Conservation Service), Census Bureau, Defense Mapping Agency, Bonneville Power Administration, Bureau of Land Management, National Park Service, and National Aeronautics and Space Administration all have in-house capabilities in surveying, mapping and aerial photography that duplicate and compete with the private sector.

The list of examples of government competition with private surveying and mapping firms goes on. The fact is, the Federal Government is spending scarce and valuable resources on surveying and mapping employees and activities that can be contracted out.

The current practice is unwise from a public policy perspective. The resources now expended to support the Federal surveying and mapping establishment could otherwise be allocated toward more pressing national priorities, or used for deficit reduction. Moreover, the practice is counterproductive from an economic viewpoint.

A provision formerly in OMB Circular A-76 limited agencies from doing work for other Federal agencies. It required

> If, by September 30, 1987, the activity has not been justified for continued in-house performance, user agencies shall obtain the required services directly from a commercial source.

This did not, in all instances, prevent agencies from performing mapping work for other Federal agencies, even when A-76 reviews had not been conducted. Now the Clinton Administration has even eliminated this protection in their recent revision to the A-76 manual.

Moreover, a 1982 law prevented Federal agencies from unfairly competing with the private sector when providing technical and specialized services to State and local government. The Intergovernmental Cooperation Act authorized Federal agencies to provide services to State and local government, but required that

> the services prescribed must be consistent with and further the policy of the United States Government of relying on the private enterprise system to provide services reasonably and quickly available through ordinary business channels. (31 USC 6505(a))

The law is implemented by OMB Circular A-97. It sets conditions under which Federal agencies can provide services to State of local government, including

> Such services will not be provided unless the agency providing the services is providing similar services for its own use under the polices set forth in Circular No. A-76. In addition, in accordance with the policies set forth in Circular No. A-76, the requesting entity must certify that such services cannot be procured reasonably and expeditiously by it through ordinary business channels.

Despite this requirement, numerous Federal agencies provide surveying, mapping and aerial photography services to State and local government. No certification that such services are not available from the private sector has ever been filed with OMB. Among the agencies that violate this Circular are NASA (aerial photography), NOS (geodetic surveys), and USGS (mapping).

Not only does unfair competition affect surveying and mapping firms here at home, but the issue also affects the U.S. trade imbalance.

In the surveying and mapping area, U.S. government agencies, not German, Japanese or other foreign firms, are the single largest competitors for U.S. firms. Again, it is because Federal agencies aggressively market their services to foreign governments. U.S. government agencies routinely receive requests from foreign governments for surveying and mapping services. In each case, agencies fulfill the needs of foreign clients with Federal employees. They handle projects with their own people while there are numerous U.S. firms with the capability and expertise to do this work. Rather than winning contracts from government agencies and gaining the export experience needed to leverage further overseas work, these U.S. firms are left sitting on the sidelines.

This practice represents a major barrier for U.S. firms attempting to export their services. When they must compete against their own government and they are "elbowed out" of markets by Federal agencies because foreign clients become accustomed to getting the required services from the U.S. government, rather than from U.S. private firms. It therefore becomes difficult, if not impossible to gain entry into these markets. U.S. Government agencies should act as "agents" for, rather than competitors of, U.S. firms and help open doors to U.S. firms that have been closed by our own government, using our own tax dollars. This will help firms, particularly small businesses, identify and penetrate foreign markets. Agencies should help these firms get their foot in the door and earn the foreign trade experience they need to expand their international marketing activities.

Even the U.S. foreign aid program, administered by the Agency for International Development (AID), works against U.S. firms. Not only does AID frequently contract with U.S. government agencies to provide surveying and mapping services to foreign governments, but when AID does contract with private firms, they often award those contract to foreign corporations.

A 1989 study by the Small Business Administration estimated that the USGS alone provided $22 million in that year in mapping related services to foreign governments, through AID. All the work was done by USGS employees, none by contract.

Each time a study has been conducted on the Federal surveying and mapping establishment, a common conclusion has been reached. Whether conducted by the White House, Congress, the agencies themselves, OMB or independent Federal research organizations, these studies recommended more contracting in the surveying and mapping field. The following are excerpts from these studies:

> private cartographic contract capability is not being used sufficiently. We found this capacity to be broad and varied and capable of rendering skilled support ... Contract capability is a viable management alternative ... Its use should be encouraged in lieu of continued in-house build-up

Office of Management and Budget
Task Force on Mapping, Charting, Geodesy and Surveying, 1973

> The Investigative Staff recognizes...contract surveys...it is essential that this option be explored more fully...early consideration must be given to the use of qualified private contractors

House Appropriations Committee
Investigative Staff
Study of BLM and Forest Service Cadastral Survey Programs, 1980

> commercial resources offer time-proven expertise and professionalism in a wide range of cartographic activities.

National Academy of Sciences
Study on NOAA's Office of Charting and Geodetic Services, 1985

> The private sector can play an important role in providing BLM with the massive amounts of data it requires for its three LIS (land information systems) components. BLM can avoid investing in necessary labor and technology by drawing on the capabilities of the private sector for the data gathering phase

Bureau of Land Management
"Managing our Land Information Resources", 1989

> (contracting) is an important management tool to raise productivity, cut costs and improve the quality of Government services (the advantage of which is) efficiency, quality and innovation in the delivery of goods and services ... specific areas where the Government could place greater reliance on private sector providers include ... map-making activities

Budget of the United States Government, FY 1990
Office of Management and Budget, January, 1989

> (USGS should be) allocating adequate NMD resources to information management and user/donor coordination, and if necessary, increasing these relative to traditional data production programs

National Academy of Sciences
"Spatial Data Needs", February, 1990

> The National Oceanic and Atmospheric Administration (NOAA) will experiment with a program of public-private competition to help fulfill its mission ... The experience of the U.S. Army Corps of Engineers, which contracts out 30 to 40 percent of its ocean floor charting to private firms, shows that the private sector can and will do this kind of work.

Office of the Vice President
"Creating A Government That Works Better & Costs Less"
Report of the National Performance Review
September, 1993

> Thirty-nine federal departments, agencies and bureaus, including the U.S. Geological Survey, National Oceanic and Atmospheric Administration, Army Corps of Engineers, Defense Mapping Agency and National Mapping Division of the Department of the Interior, employ 7,000 workers and spend approximately $1 billion in surveying and mapmaking. Mapmaking is a service that is readily available from private industry at competitive costs. All government mapmaking activities should be opened to bids from private-sector suppliers.

Heritage Foundation
"Cutting the Deficit and Improving Services by Contracting Out"
March, 1995

Our great free enterprise system is based on the laws of supply and demand. The Federal Government should not be the supply for mapping, it should be the demand for mapping when there is a public interest to be served.

Legislative Solutions

To remedy this situation, we would recommend that Congress take these steps:

With regard to generic solutions to benefit the entire small business community --

o Enact H.R. 28, introduced by Representative Duncan of Tennessee and more than 40 cosponsors, and S. 1724 by Senator Thomas of Wyoming, to establish a process by which the Office of Management and Budget will identify government activities that are commercial in nature and implement a plan to contract those activities to the private sector during a 5-year period.

o Amend the Small Business Act to expand the responsibilities of the SBA Chief Counsel for Advocacy to identify Federal activities which duplicate or compete with the private sector, including small and small disadvantaged business, and be an advocate for contracting to the private sector. Current law does not make this a specific charge to that office. That should be changed.

o Enhance the duties of and responsibilities of the Breakout Procurement Center Representatives (PCRs) to identify Federal equipment purchases to build in-house capabilities that duplicate or compete with the private sector, including small and small disadvantaged business, and require government agencies to acquire services from the private sector, rather than buying equipment that duplicates private sector capabilities, and

o Amend the Treasury, Postal and Related Agencies Appropriations bill on the House floor to prevent OMB from implementing the revision to A-76 that would permit agencies from doing work for other agencies in competition with the private sector.

With specific regard to surveying and mapping --

○ evaluate all Federal programs in order to determine mapping that can be commercially provided. Spending on these programs should be eliminated in order to empower market forces to provide this mapping; and

○ redirect Federal agencies to those aspects of mapping to those functions and responsibilities that are more appropriate for the government, such as standards setting, coordination of user agency requirements and dissemination of government data to user agencies.

We would urge the Committee to include these provisions in the SBA reauthorization bill to be marked-up later this week.

The House will also soon consider the Treasury, Postal and Related Agencies Appropriations bill. We would urge an amendment to this bill to prohbit OMB from implementing any directive that permits Federal agencies to provide commercially available goods or services to other government agencies.

Let me add one final point. Contracting with the private sector should not be viewed as a threat to government employees. We have hired talented personnel from government agencies, as has many of my colleagues in other mapping firms. Any suggestion that contracting out will throw government workers out on the street is a scare tactic and is not supported by the facts.

During the past year, as a result of pressure from Congress, particularly through the appropriations process, some agencies have begun to increasing contracting. This has been particularly true of the USGS and NOAA. However, their progress is far too slow. Each day the government continues its in-house mapping production activity it puts the taxpayers and private mapping firms at a disadvantage. We would urge the enactment of legislation in this session to provide a long over-due remedy to the problem of government duplication of and competition with the private sector. We believe Congress should focus government agencies on those inherently governmental activities that only government can perform, while relying on the private sector for those activities that are commercial in nature.

We thank you for this opportunity to testify and look forward to working with you to advance these and other solutions to a very serious problem affecting America's small firms.

FEDERAL EMPLOYMENT VERSUS CONTRACTING SURVEYING AND MAPPING 1994

DEPARTMENT/ AGENCY	EMPLOYEES	CONTRACTS ACTIONS	$$$
AGRICULTURE	631	207	5838
COMMERCE	683	8	495
ARMY (incl. USACE)	528	131	8293
NAVY	39	277	27341
AIR FORCE	19	118	13473
DMA	3250	30	4485
DEFENSE (TOTAL)	3836	556	53598
ENERGY	18		
INTERIOR	1827	212	18402
STATE	3	8	4862
TRANSPORTATION	35		
VETERANS		1	32
FEMA	1		
EPA	2	15	1520
PANAMA CANAL COMMISSION	4		
INTERNATIONAL BOUNDARY COMMISSION (US/MEX)	5		
GSA		2	2
TOTAL	7045	1565	84749

EMPLOYEES September 30, 1994, Combined Cartography, Cartographic Technician, Land Surveying, Surveying Technician, Geodesy, Geodetic Technician, Photographic Technician occupation codes, permanent full time and permanent part time positions. SOURCE: Office of Personnel Management.

CONTRACTS FY 1994 (in $000). Includes all contracts greater than $25,000 in service codes R404 Land Surveys, Cadastral Services; T002 Cartography Services; T004 Charting Services; T008 Photogrammetry Services; T009 Aerial Photography Services; T014 Topography Services. SOURCE: Federal Procurement Data Center, GSA.

MAJOR FEDERAL AGENCIES

ENGAGED IN SURVEYING AND MAPPING

Department of Agriculture

Natural Resource Conservation Service
Forest Service

Department of Commerce

National Oceanic and Atmospheric Administration
Census Bureau

Department of Defense

Air Force
Corps of Engineers
Defense Mapping Agency
Naval Engineering Facilities Command

Department of Energy

Bonneville Power Administration
Office of Information Resources

Department of Health and Human Services

Public Health Service

Department of the Interior

Bureau of Indian Affairs
Bureau of Land Management
Bureau of Reclamation
Fish & Wildlife Service
Geological Survey
National Park Service
Office of Surface Mining

Department of Justice

Bureau of Prisons
Drug Enforcement Administration
Federal Bureau of Investigation
Immigration & Naturalization Service

Department of State

Agency for International Development
Office of the Geographer

Department of Transportation

Coast Guard
Federal Aviation Administration
Federal Highway Administration
Federal Transit Administration
Office of Pipeline Safety

Department of Treasury

Customs Service

Department of Veterans Affairs

Office of Facilities

Independent Agencies

General Services Administration
Environmental Protection Agency
Federal Emergency Management Agency
International Boundary Commission
National Aeronautics and Space Administration
National Capital Planning Commission
Panama Canal Commission

Suggested Legislative Solutions

I. AMENDMENT TO THE TREASURY, POSTAL SERVICE AND GENERAL GOVERNMENT APPROPRIATIONS BILL:

> None of the funds in this or any other Act may be used by the Office of Management Budget, or any other agency, to publish, promulgate or enforce any policy, regulation, circular or other instrument that would permit any Federal agency to provide a commercially available good or service to any other governmental entity or agency unless the Federal agency can provide such product or service more economically than the private sector.

Rationale

The Clinton Administration has changed a 40-year Federal policy, supported by Republican and Democrat Presidents since the Eisenhower Administration, that the Federal government should rely on the private sector for commercially available goods and services and that the government should not compete with the private sector.

Included in the old policy was a provision which required

> If, by September 30, 1987, the activity has not been justified for continued in-house performance, user agencies shall obtain the required services directly from a commercial source.

Even this provision did not eliminate agency performance of work for other Federal agencies, however, this protection was in place and could be used by the private sector to police abuses by agencies.

Rather than strengthening that requirement, which was designed to be one of the fundamental protections for small business from unfair government competition, OMB has hoisted a white flag and adopted a new policy that condones what are now called Interservice Support Agreements, or ISSA's.

The new policy says:

> Effective October 1, 1997, the cost comparison requirements of this Supplemental handbook will not apply to existing or renewed ISSAs or to the consolidation of commercial or other services within a Department or agency.

The new policy grandfathers all existing schemes that permit one federal agency to provide commercially available goods and services to other agencies. For example, if the USGS does mapping for the National Park Service, even though mapping is available from the private sector and even though the USGS has not conducted any cost analysis to determine if its mapping services are more cost effective than the private sector, the USGS, under the new policy, can continue to perform this service for the National Park Service.

This policy puts the private sector, particularly small business, at a severe disadvantage. First, it puts government agencies into competition with the private sector. That alone is not good public policy and is an anathema to our free enterprise system. Second, these inter-agency agreements are not truly competed. Even if one accepts the premise that government agencies should be permitted to perform commercial activities for other government agencies -- compete with the private sector -- there should at least be competition. However, there is no requirement is Federal law, regulation, policy or anywhere else that agencies issue public solicitations when they seek these services from other agencies. The private sector never even knows there is a need or requirement. The inter-agency agreements are back-room deals. They are sole source procurements. There is no pubic notice, no competition, no bid or proposal from the private sector, no cost analysis.

Not only is this policy bad for small business, but it is bad for the taxpayer as well. Why is it that agency A can do business for agency B? The answer is simple -- they have an excess capacity. Agency A has more people than they need, more equipment than they need, more time than they need, and therefore, more money than they need. So they use this slack, this excess capacity, to market their services to other government agencies. Or, in other cases, if an agency is facing budget reductions and a reduction in their work force, they get very creative, innovative and enterprising and market their services to other agencies so that can make up in reimbursable work the funds they otherwise have lost in appropriations from Congress.

This costs taxpayers millions of dollars each year. It costs small business millions in lost business opportunities. It thwarts the will of Congress with regard to limiting the size of government and reducing the deficit. It also runs counter to the recommendations of the 1980, 1986, and 1995 White House Conference on Small Businesses.

II. ASSIGNMENT OF ADDITIONAL FUNCTION TO OFFICE OF ADVOCACY.

Section 5(b) of the Small Business Act is amended--

(1) by striking "and" at the end of paragraph (10);

(2) by striking the period at the end of paragraph (11) and inserting "; and"; and

(3) by adding at the end the following new paragraph:

"(12) in consultation with organizations representing the interests of small business concerns, identify and make annual reports to Congress concerning activities performed by Federal agencies or performed by State or local government agencies utilizing a grant, loan cooperative agreement, or other Federal assistance that--

"(A) duplicate or compete with private enterprise and can be performed by private firms (including small business concerns and small business concerns owned and controlled by socially and economically disadvantaged individuals) at lower overall cost to Federal, State, or local government; and

"(B) are not inherently governmental in nature and, if performed by private firms would not impede the mission of the government agency.".

Rationale

The Small Business community has no office in the Federal government to approach to remedy

instance of unfair government competition. Current law does not include this responsibility in the Office of the Chief Counsel for Advocacy.

III. AUTHORITY OF BREAKOUT PROCUREMENT CENTER REPRESENTATIVES.

Section 15(l)(2) of the Small Business Act (15 U.S.C. 644(l)(2) is amended--

(1) by striking "and" at the end of subparagraph (F);

(2) by striking the period at the end of subparagraph (G) and inserting "; and"; and

(3) by adding at the end the following new subparagraph:

"(H) identify and make recommendations concerning Federal procurements of supplies (including equipment) or services that may result in the performance by a Federal department or agency of activities which--

"(i) duplicate or compete with private firms and can be performed by private firms (including small business concerns and small business concerns owned and controlled by socially and economically disadvantaged individuals) at lower overall costs to the United States; and

"(ii) are not inherently governmental in nature and, if performed by private firms would not impede the mission of the department or agency.".

Rationale

This office, which is intended to expand contracting opportunities for small business, does not, under current law, include the responsibility to identify Federal activities performed in-house by the government that can be performed by the private sector, including small business. This provision would add that responsibility to the PCRs and give small business a place to promote contracting and remedy unfair government competition problems.

IV. FREEDOM FROM GOVERNMENT COMPETITION ACT

Sec. ___ of the Small Business Act is amended by adding the following:

SEC. 1. This Title may be cited as the "Freedom from Government Competition Act of 1996".

SEC. 2. FINDINGS.

The Congress finds and declares that--

(1) private sector business concerns, including small business, which are free to respond to the private or public demands of the marketplace, constitute the strength of the American economic system;

(2) competitive private enterprises are the most productive, efficient, and effective sources of goods and services;

(3) Government competition with the private sector of the economy is detrimental to the American economic system, especially small business;

(4) Government competition with the private sector of the economy is at an unacceptably high level, both in scope and in dollar volume;

(5) current law and policy have failed to address adequately the problem of Government

competition with the private sector of the economy; and

(6) it is in the public interest that the Government establish a consistent policy to rely on the private sector of the economy to provide goods and services necessary for or beneficial to the operation and management of Government agencies and to avoid Government competition with the private sector of the economy.

SEC. 3. DEFINITIONS.

As used in this Act the term "agency" means--

(1) an executive department as defined by section 101 of title 5, United States Code;

(2) a military department as defined by section 102 of such title; and

(3) an independent establishment as defined by section 104(l) of such title.

SEC. 4. PROCUREMENT FROM PRIVATE SOURCES.

(a) POLICY. -- It shall be the policy of the Federal Government that each Federal agency should obtain all goods and services necessary or beneficial to the accomplishment of its authorized functions by procurement from private sources, including small business, and it will not provide a product or service for its own use if such product or service can be procured from the private sector, including small business.

(b) GENERAL RULE.--Notwithstanding any other provision of law, each agency shall obtain all goods and services necessary for or beneficial to the accomplishment of its authorized functions by procurement from private sources, including small business, unless the head of the agency determines and certifies to the Congress in accordance with regulations promulgated by the Administrator of the Small Business Administration that--

(A) Government production, manufacture, or provision of a good or service is necessary for the national defense;

(B) a good or service is so inherently governmental in nature that it is in the public interest to require production or performance, respectively, by a Government employee; or

(C) there is no private source capable of providing the good or service.

(b) REGULATIONS.--The Administrator of the Small Business Administration shall promulgate such regulations as the Administrator considers necessary to carry out subsections (a) and (b).

SEC. 5. STUDY AND REPORT.

The Administrator of the Small Business Administration, in consultation with the Director of the Office of Management and Budget, the Comptroller General of the United States, and representatives of small business, shall carry out a study to identify all current activities of agencies which are inconsistent with the requirements of section 5(a) and shall transmit to the Congress within one year after the date of enactment of this Act a report on such study. The report shall include a list of all activities identified under the preceding sentence and a schedule for the transfer of such activities to the private sector of the economy. The schedule included in the report shall provide for the completion of the transfer within 5 years after the date on which such report is transmitted to the Congress.

Rationale

This provision squarely implements the recommendation of all three White House Conference on Small Business agendas. It establishes a statutory Federal policy on reliance on the private sector, a process for implementation, and reasonable exemptions for products and services that should indeed be performed by the government, rather than the private sector. This amendment is based on H.R. 28/S. 1724 introduced by Rep. Duncan and Sen. Thomas, respectively, but assigns the lead responsibility to the SBA Administrator rather than the OMB Director.

Written Testimony of
Frank L. Jensen, Jr., President,
Helicopter Association International
before the
House Committee on Small Business
July 16, 1996

UNFAIR COMPETITION AND ITS IMPACT ON SMALL BUSINESS

Madam Chairman, Ranking Member LaFalce, and distinguished members of the Committee, thank you for the opportunity to appear before you today and discuss an issue of mounting concern to the entire small business community: unfair government competition. I am Frank L. Jensen, Jr., president of the Helicopter Association International (HAI). For the past forty-eight years, HAI has dedicated itself to promoting the safe operation of civil helicopters.

Our members put helicopters to work by flying a wide range of missions which fill market demands for such needs as agricultural crop applications, energy exploration and production, aerial sightseeing, and many others. They conduct fire-fighting missions by dropping fire retardants into the blaze and by transporting personnel into position and out of harms way. They also lift equipment into places only accessible by helicopter and provide airborne ambulance services.

The majority of HAI's operators are small businesses. More than 75 percent of them operate four or fewer helicopters.

At the outset of this testimony, I would like to emphasize that HAI strongly supports the rule of law as absolutely essential to protect the citizenry and to facilitate commerce. We understand the need for a realistic governmental structure to serve the needs of the citizenry, including emergency services and law enforcement.

Governments—ranging from local municipalities to the federal government—use helicopters to perform tasks that can only be accomplished by helicopters. That becomes good news and bad news.

The good news is that governmental entities recognize the utility and value of helicopters in the accomplishment of their official functions. The bad news is

that there is little or no oversight of government helicopter operations, and some public sector operators take advantage of this by encroaching into the private sector. Please note that such encroachment occurs all too frequently in all areas of commerce and industry, not just helicopters. The 1995 White House Conference on Small Business identified government encroachment as one of the most serious threats to small businesses. To solve the problem, the report advocates that to...

> "Support fair competition: congress should enact legislation that would prohibit government agencies, tax- and antitrust-exempt organizations from engaging in commercial activities in direct competition with small business."

I am here today to support this legislative goal. The *Freedom from Government Competition Act of 1995* will go a long way to help sustain small businesses. It will result in more jobs. Conversely, some of our members have cut back their operations and staff because government helicopter operators have encroached into the marketplace with their tax-supported fleets.

The following are examples:

- A private critical-care air medical transport service based in Baltimore is faced with competition from the Maryland State Police, which has expanded its operations from transporting injured persons from accident scenes to transporting critical care patients from one hospital to another. The unfairness is compounded by the fact that the Maryland State Police are not required to follow either the same FAA regulations nor provide the same level of medical personnel onboard the aircraft while transporting the-critical care patient between facilities. And of course all of the police helicopter expenses are paid by taxes.

Hospital administrators thus have taxpayers footing the bill for transporting patients with little or no charge to them, instead of collecting from patients and insurance companies. The next example drives that point home:

- Last December, a fully certified air-medical-transport company took a call from Fisherman's Hospital in Florida to transport a patient to another hospital. A private-sector crew of three stood by for a departure time. After waiting and repeatedly calling the hospital for 2½ hours for a departure time, they learned that Metro Dade Fire Rescue performed the service at no charge to the hospital (but the taxpayer paid of course).

- Over a nine-month period, the California Highway Patrol, based in Napa, California, performed 23 patient rides between hospitals. Qualified private operators were available for 18 of those transfers!

- Last February in Oregon, the Lane County Sheriff's helicopter transported a news reporter over flood areas. Clearly, this is not a public-sector function and, if the county was paid for the ride, it violates Public Law 103-411.

- Private helicopter companies were meeting the needs of fire fighting operations in San Diego County in California when they observed two helicopters from San Bernardino County Sheriff's Department transporting passengers to and from the fire zone. There is an abundance of qualified private-sector helicopter operators throughout the region. Again, this is in direct violation of Public Law 103-411.

We have many such examples of tax-sponsored competition, happening every day all across the country. In many cases, government operators are not only stealing business away from private operators but are intimidating them when they report the problems to officials.

In our industry, both the private and public sectors use the same types of helicopters. They perform the same missions and this exacerbates the problem of encroachment.

There are several major factors to consider when government steps outside of its role of governance and into the role of commercial competitor in the marketplace. These considerations are both philosophical and economic.

Let us consider the philosophies of commerce and governance.

Government must govern. It must be the traffic light and not the traffic. Let government govern and private enterprise produce goods and services. That's what made America the great power that it is today. That is why we prevailed over socialism all around the world. *The degree to which legislative decision-makers allow government to offer goods and services, is the same degree to which they allow America to become a socialist nation.*

The bestseller, *Reinventing Government* by David Osborne and Ted Gaebler, has been used by Vice President Gore in his National Performance Review. E. S. Savas, chairman of the Department of Management at City University of New York, wrote the preface to the first chapter of that book. He says:

> "The word government is from a Greek word, which means 'to steer.' The job of government is to steer, not row the boat. Delivering services is rowing, and government is not very good at rowing." (p. 25)

HAI fully agrees with this statement.

The report of the 1995 White House Conference on Small Business reinforces the small-business community's continuing plea to keep governments out of private-sector competition. One solution offered in the report is to strengthen and expand OMB circular A-76 by making it apply "to all federal monies used directly or indirectly in the provision of goods and services..."

Increasingly, government entities are charging into the market place—completely ignoring federal regulations and policies. One must ask: "Are there any laws, interpretations of law, rules or regulations on the books that prohibit the federal government from competing with private businesses?"

I posed that question last Thursday to the administrator of the Office of Federal Procurement Policy, Dr. Steve Kelman when he was addressing the Small

Business Legislative Council. He replied that he knew of no such enforceable language and added that he did not think that direct government competition was a big problem. The audience was stunned. Every single attendee had examples of government competition to relate.

Again, in a free society the costs of all government functions are paid from tax revenues. Hopefully, intelligent persons, whether private or public sector, would agree that:

1) To best represent the interests of taxpayers, governmental functions should be accomplished in the most cost-effective manner. Private enterprise outperforms government-operated businesses every time. They do it cheaper and better. And, in the case of the helicopter industry, private operators are held to much higher standards of safety, maintenance and training than government-owned operations.

2) Governments should advocate and encourage the growth of the private sector, for the well-being of the citizenry, and to ensure the viability of a healthy tax base. When honest and complete cost analyses of goods and services are accurately compared, the economic performance of the private-sector business is consistently superior to the government-sponsored competitor.

Often it is difficult, or even impossible, to accurately compare the costs of private vs. public because totally different accounting methods are used. These ambiguities are especially conspicuous when attempting to compare costs of helicopter operations. Public entities often are self insured but there is an implicit cost. When a government-owned, self-insured business becomes liable, it passes the cost on to taxpayers. But when a private business becomes liable, there is no added burden to the tax payer. Safety is the number one objective in the helicopter industry. These economic considerations mean that private operators have more economic incentive to operate safely than their government-sponsored competitors.

Conclusion

Basic American values are operational in this debate. A vibrant tax base is crucial to driving America's prosperity and sovereignty. This is why HAI wholeheartedly supports passage of H.R. 28 and its companion bill in the Senate, S.1724. The degree to which governments govern, and refrain from engaging in commercial enterprise, is the degree to which America will prosper.

Opening Statement of
The Honorable John J. LaFalce
July 18, 1996

Small Business Committee Hearing on Unfair Government Competition

Thank you, Madame Chairman, for holding these two hearings this week on an issue of great interest to a number of small businesses. I regret I was unable to be present for Tuesday's hearing due to a scheduling conflict.

The importance of unfair government competition is indicated by the fact that it was ranked 14th of all the recommendations adopted by delegates to the 1995 White House Conference on Small Business.

The variety of types of businesses represented by the witnesses, both Tuesday and today, suggests how extensive is the problem of private sector competition from the public and not-for-profit sectors: a broad spectrum of goods and services obviously is involved.

I understand Tuesday's hearing was interesting and informative, and I am sure today's will be as well. I look forward to hearing the experiences of the panelists and their suggestions for ameliorating the situation.

Thank you, Madame Chairman.

Committee on Small Business
U.S. House of Representatives

HEARING

on

Unfair Government-Supported Competition With Small Business:
Recommendations from the 1995 White House Conference on Small Business

July 18, 1996
9:30 a.m.

OPENING STATEMENT

Rep. Jan Meyers
Chair

Today, the Committee on Small Business meets to receive further testimony regarding unfair competition with small business. This hearing is a continuation of the Committee's efforts to explore an issue that was voted 14th among the Top-60 Recommendations by the delegates to the 1995 White House Conference on Small Business. A similar recommendation was ranked 3rd by the small business delegates to the 1986 White House Conference, and among the top 25 recommendations during the first White House Conference on Small Business in 1980.

This past Tuesday the Committee looked at a core component of this small business issue — direct competition by government entities. On June 27th, the Committee explored the competition small businesses faced from the expansion of Federal Prison Industries. This, too, has been an issue on which the Committee has afforded the small business community opportunities to share their experiences and voice their support for remedies, legislative or otherwise.

Today's hearing focuses on a different component of the unfair competition issue, unfair competition provided by various forms of not-for-profit entities. Such organizations have been accorded a broad advantages by statutes and other Government action. To the small business owners with whom they compete, whether for government contracts or commercial business, these many preferences put small firms at a serious, if not insurmountable, disadvantage.

Our first witness, the Vice Chairman of the Business Coalition for Fair Competition, will provide a broad context of what the White House Conference delegates saw as this component of the issue of unfair competition with small business. Subsequent witnesses will provide specific examples of the advantages enjoyed by these not-for-profit entities. They will also demonstrate that like unfair government competition, the problem is a growing one. The reasons are approximately the same, financial pressures to be more and more entrepreneurial as their traditional sources of funding have dried-up.

This component of the unfair competition issue also includes the competing policy tensions that pervade this entire issue. It is especially prevalent when exploring the competition provided by the broad array of not-for-profit service organizations. They provide valuable services to their communities. They serve populations within those communities that rely deeply on the assistance they provide. This is especially true of the programs run by the various organizations serving the blind and severely handicapped.

I look forward to the testimony of today's witnesses.

HOUSE FULL COMMITTEE ON GOVERNMENT PROGRAMS

UNFAIR GOVERNMENT COMPETITION WITH SMALL BUSINESS

Opening Statement for Congressman Glenn Poshard

July 18, 1996

Mr. Chairman, I appreciate your holding this hearing on Unfair Government Competition with Small Business.

The mission of this committee is to provide a conducive environment for small businesses. The purpose of this hearing is to determine to what extent government involvement in this process is desirable. Competition between private industries and government agencies is a growing concern, and we certainly do not want to create a detrimental climate for small businesses, as their value to our nation's economy cannot be overstated.

I look forward to hearing from the esteemed panel of witnesses this before us today. I look forward to continuing to work with this committee before us today to find solutions to this and the many issues small businesses face across this nation.

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July 18, 1996

Let me introduce myself and at the same time, tell you a little about my own background, technical as well as otherwise, and how it is that I come to speak today before the U. S. House Committee on Small Business. Although I am a member of numerous scientific and technical organizations and societies, I come before you today speaking only for my small laboratory and from my own personal experiences. I also come before you with the experience of having served as both elected and appointed delegate to the three White House Conferences on Small Business (1980, 1986, and 1995).

After receiving my undergraduate training from the U. of Illinois Champaign/Urbana in Chemical Engineering, I earned my Ph. D. in "Engineering" from what was then called Case Institute of Technology (now Case Western Reserve University) but all of my research and thesis work was in the area of Polymer Physics. My main tool of analysis to do my thesis work, between the years of 1963 - 1967 was the electron microscope, or what we would now call the transmission electron microscope (TEM). My first job out of graduate school, in December 1967, was at DuPont in Wilmington, DE where at their Experimental Station research labs, I was put in charge of (what was then) the Plastics Department electron microscope laboratory. This was no minor position for a young Ph. D. out of school since the Plastics Department at that time was larger than most large chemical companies.

I was treated extremely well by DuPont, however, I seemed to always be listening to a "different drummer" and maybe it was quite simply that I was too impatient, but I concluded that the happiness I was seeking, professionally as well as for my own career, would be found only by starting my own small business. And while working at DuPont, I had the opportunity to have considerable contact with a new kind of electron microscope, the scanning electron microscope, or SEM as it is now called. In fact, during that time, in 1968 and 1969, I had the chance to see how this new kind of microscope could be used to solve all kinds of problems before most other technical people in the microscopy world even knew such an instrument existed.

So by 1970, I saw the opportunity to purchase my own SEM, leave DuPont and start my own small laboratory business. I did not have any capital of my own, after all, I was just out of school, however, based primarily on my own visibility in the microscopy field, as well as with help from a venture capital company, I was able to secure the credit to get the company

are in compliance with NSF Important Notice 91, and indeed someone might very well be signing off on such a document, the fact is that

a) Many of those who run some of the largest NSF funded analytical instrumentation laboratories, don't even know of the existence of NSF Important Notice 91.

b) When those running some of these instrumentation laboratories learn about the existence of such a document, they have great difficulty obtaining a copy of it from NSF.

c) And some of those who are aware of it, when asked, respond with such a level of arrogance, that it is truly astonishing.

d) And there are some who just see the NSF and other agency funded instrumentational assets as if they were their own to use for their own private consulting businesses and essentially run such businesses, unhindered, out of their own university laboratories.

Now this is not simply a case of saying that this is a matter of "tightening up" the tax laws. If somehow, suddenly, all of the universities who are using their facilities this way, competing with private firms, were in fact exposed to taxation, *it probably would not make any difference.* History has shown that in the case of large not-for-profits, when they set up a for-profit subsidiary, especially when the subsidiary is small in comparison to the size of the parent, by fine tuning the allocation of certain costs, there is quite a bit of latitude to make sure that the now taxable entity is still not "profitable". This is always the explanation that is given to explain why the UBIT (unrelated business income tax) collections consistently are at fractions of the levels that would otherwise have been projected by the IRS.

And if anyone would really believe that the nation's universities could police themselves, then they never heard of the fox guarding the chicken coop. The history of the past twenty year period is that the presidents of the nation's universities are sometimes themselves the ones responsible for at least some of the misguided intentions on the part of some of the faculty members.

Accompanying this testimony will be some "attachments". It has always been difficult for a small laboratory such as my own to actually extract and obtain documented information as to specific clients going to specific laboratories on a timely basis. After all, we not only have our own businesses to run, we also, do not want to be in the position where someone could threaten legal action. But the rapid growth of the internet, for private laboratories, has been both good and bad. It has been bad, because it is now enabling universities to promote their services to an even greater degree and at even lower cost since they have access to their "edu" or free connection to the internet.

On the other hand, it permits someone like myself, and if I can do it, then it should be even easier for an Inspector General of some agency like the NSF, to find out and document what actually is going on.

Attached you will find the following:

At least these people are honest: *The candidate must be able to handle a wide variety of incoming sample analyses from within the department, the University, and the surrounding industrial users (Hercules, Micron, Thiokol, etc.).* The U. of Utah has a long history of competition with for-profit tax-paying laboratories in the analytical services areas.

Attachment #5: PRA Analytical Services

At direct quote from their brochure: *Our Analytical Services Division resides in a modern fully equipped 8,000 square foot laboratory located on the campus of Eastern Michigan University. With the resources and academic environment of Eastern Michigan University, and our private staff of coatings analysts, we can provide the best of both worlds...*

Attachment #6: Price comparison (fixing) of university researchers

In response to a request for universities to compare prices being charged for commercial clients, the following table was compiled. It speaks for itself. Where separate industrial prices are given, the charges are a fraction of what would be charged by a commercial laboratory. At those institutions where separate industrial rates are not given, what is the case generally, is that a professor will submit a sample to the services laboratory and the receiving laboratory never knows that the sample being run is for an outside customer. Everything is sort of all mixed in together and no one knows whether they are coming or going with regard to the charges. Usually, some government contract end up actually "paying" for the industrial samples, with the professor pocketing the difference in the form of a "consulting fee".

Question: If a group of for-profit providers of a service sat down and collected price information of this type, would not federal laws be getting broken? Somehow if you are in a university environment, you think of yourself as being *above* the law.

Attachment #7: Arizona State University

This is the department run by Prof. John Wheatley. Be sure to reference his listserver posting in Attachment #3. I have noted the statement: *In 1988 an Industrial Associates Program (HREM-IAP) was established in the field of high resolution electron microscopy to promote interaction between academic and industrial scientists with interests in HREM.*

And in another part of the brochure is stated that membership payment includes *120 hours use of the Center's electron microscopes and other equipment per year with provision for extension if needed.*

Although most universities with such "industrial affiliates" programs would deny it, the fact is that the annual payment is really a disguised advance payment for future services to be provided. At least ASU is honest about it and puts it up front. While it is a fact that the Center does have some truly unique instrumentation, the fact is that most of the usage by the affiliates is not of this cutting edge instrumentation but of the more garden variety SEMs and TEMs, that is, the kinds of equipment that exist in private for profit laboratories across the USA.

Microscopy Services

ATTACHMENT # 1

Dennis Kunkel / MicroVision offers custom microscopy and photomicrography services for Research, Education, Industrial and Commercial applications. Microscopy and photomicrography services are available as follows:

Microscopy

Light Microscopy (LM)

Optical microscopy and photomicrography by use of dissecting and compound microscopes. Light is transmitted through or reflected from a sample in order to visualize its components. Magnification range from 5 to 1500 times. Illumination techniques available:

1. Brightfield
2. Polarized
3. Darkfield
4. Phase Contrast
5. Rheinberg
6. Differential Interference Contrast

Video Light Microscopy (VLM)

High resolution video camera is used to capture movement in living organisms, and to conduct structural analyses. High quality video microscopy is available for all types of illumination techniques.

Transmission Electron Microscopy (TEM)

In an electron microscope electrons are used instead of light to visualize a specimen. Electrons are transmitted through a sample much like light in an optical microscope. However, instead of glass lenses focusing the light wavelengths, electromagnetic lenses are used to focus the electrons on the sample. The sample must be specially prepared to a thickness which allows the electrons to transmit through the sample. Because the wavelength of the electrons is much smaller than the wavelength of light the optical resolution attainable for TEM images is many times greater than that achieved by the light microscope. Thus, the TEM can reveal the finest details of internal structure - in some cases as small as individual atoms. Magnifications of 500 to 500,000 times are routinely obtained. For biological samples, cell structure and morphology are commonly determined. Microstructural characterization of nonbiological materials, including unit cell periodicity, can be readily determined using various combinations of imaging and diffraction techniques in the electron microscope. Images obtained from a TEM are two dimensional sections of the subject, but applications which require three dimensional reconstruction can be accommodated.

Scanning Electron Microscopy (SEM)

As with the transmission electron microscope the scanning electron microscope uses electrons to image a specimen. Electrons are scanned across a sample and high resolution images can be viewed. Due to the energy and the wavelength of the electrons used to create the image a great depth of field and high resolution are achieved. Very fine details on the morphology and topography of biological and nonbiological samples can be obtained. Magnifications can range from 10 to 300,000 times. Unlike The TEM, the SEM conveys three dimensional information which is important in interpreting structural organization.

the public. Products include:

- Calendars
- Cards
- Puzzles
- Posters
- Coffee mugs
- Mouse pads
- Music jackets
- T-shirts
- Sweatshirts
- Aprons
- Swim Wear
- Active Wear

You can obtain information on microscopy services by contacting Dennis Kunkel.

BETA

ATTACHMENT #2

The BETA ANALYTIC INC. mail room
- how to contact us!

If you have any comments, requests or would like more information on submitting samples for analysis, you can e-mail us directly from this site.

PHONE:
(01) 305-667-5167

FAX:
(01) 305-663-0964

MAILING ADDRESS:
Beta Analytic Inc.
University Branch
4985 S.W. 74th Court
Miami, Florida
USA 33155

And while you're here, if you wish to save our URL to your browser's hotlist, it's:
http://www.win.net/~analytic/

Back to the MAIN MENU

BETA

SCANNING ELECTRON MICROSCOPY (SEM)
of materials submitted for radiocarbon dating

Scanning Electron Microscopy (SEM) can be used to magnify objects up to 10,000 times.

SEM photographs showing microscopic details provide very useful information in the interpretation of radiocarbon dates. For instance, SEM can be used to distinguish primary vs. secondary shell structure and to identify very small wood, charcoal and carbonate samples. SEM micrographs are also an excellent addition to reports and theses.

Click here to view SAMPLE SEM IMAGES from Beta Analytic Inc. (151 KB)

APPROPRIATE MATERIALS:
SEM is especially useful for AMS samples. It is recommended for: very small carbonates which cannot be pretreated (forams, ostracods, coccoliths), or unidentified macro-fossils concentrated from sediments (wood or charcoal for which some taxon identification is useful).

THE SERVICE:
Three (3) micrographs of various angles and/or magnifications are provided for each sample. Micrographs are obtained on a representative portion of the material submitted for radiocarbon dating, not on the dated material itself. The technician will usually be able to choose the angles and magnifications which are most appropriate. The service does not include identification or characterization, but wherever possible, some will be provided.

COST:
The cost is $60 per sample when performed with C14 dating (call for prices when not performed with C14 dating.) Additional micrographs are available for $20 per photo per sample (minimum of 2).

Back to the MAIN MENU

ATTACHMENT #3

COMPETEA.TXT Friday, July 12, 1996 3:16 pm

From: PO2::"John.Wheatley@ASU.Edu" "John C. Wheatley" 19-JUN-1995 12:12:31.79
To: Microscopy@aaem.amc.anl.gov
CC:
Subj: Legal/Ethical Question

I am interested in the legal and ethical arguments (pro and con) for university involvement with industrial entities in the area of electron microscopy. In other words, is it legal/ethical for universities to use university instruments to solve problems for industry on a fee-for-service basis? I would like to have replies from anyone who wishes to respond. However, I realize that regulations may be different in other countries and therefore I ask that your responses be sent directly to me so our international friends are not bored with American legal/ethical discussions. I will provide a compilation of the responses to all who ask for them, except when individual respondents request otherwise.

With respect to the legal side of the question, I would like to have answers based upon actual legal opinions that you are aware of. Perceptions about legality will not be useful. I know that there are probably very few (maybe none) lawyers involved in electron microscopy. If your institution has issued a legal opinion with respect to this issue, I would like to know what that opinion is.

I would find it useful to have many people respond to this request. I would especially like to have those members of the private sector, who use electron microscopes to solve problems for industry, respond.

If you feel comfortable responding, please include your price structure for industrial jobs--proprietary and otherwise.

I thank you for your responses.

John C. Wheatley
Lab Manager
Center for High Resolution Electron Microscopy--Arizona State University

John C. Wheatley
Lab Manager
Center for High Resolution Electron Microscopy
BOX 871704
Tempe, AZ 85287-1704
Phone: (602) 965-3831
FAX: (602) 965-9004
John.Wheatley@ASU.Edu

is already available to draw from? (As with John's request, feel free to reply directly rather than through the listserver.)

Cheers. /philf :)

//\/\/\/\-->
// Phil Fraundorf, Physics & Astronomy: 3145165044 c4647@slvaxa.umsl.edu
\\ U. Missouri - St. Louis MO 63121 USA http://newton.umsl.edu/pfhomepg
\\/\/\/\/\/\/\/-->

COMPETEA.TXT Friday, July 12, 1996 3:16 pm

From: PO2::"walcksd@ml.wpafb.af.mil" "Scott D.Walck@ml.wpafb.af.mil, WL/M
LBT" 20-JUN-1995 07:13:32.65
To: Microscopy ListServer <MICROSCOPY@aaem.amc.anl.gov>
CC:
Subj: Re: Legal/Ethical Question

I've been at two places, Florida and U of Al at Birmingham. I was involved
with setting up the lab at UAB. At that time, (~'87) their was an uproar
somewhere in the country where rates at a particular university was
substatially less than a competing commercial lab. I believe that the issu
e
was resolved when the university started charging the same rates. The
consensus of the people I talked to regarding rate charges at other public
ly
supported schools was that if there was a commercial lab anywhere in their
state, that higher or comparable rates should be charged to avoid competing
with tax paying businesses.

We also chose to use a statewide criteria for setting our rates, however, w
e
did thoroughly discuss the ethical considerations with respect to the fact
that
a significant portion of federal funds were used to purchase our instrument
s.
We chose the state criteria with the caveat that if a lab out of state
complained that we were undercutting their business, we would raise our rat
es
appropriately. Fortunately, we never encountered a problem.

-Scott Walck

From: PO2::"merock@u.washington.edu" "Michael Rock" 20-JUN-1995 14:47:05.
12
To: "John C. Wheatley" <John.Wheatley@ASU.Edu>
CC:
Subj: Re: Legal/Ethical Question

John-
in response to legal/ethical.
I think they are separate issues and need to be tackled as such.
1) legal
I have been involved in such a system at a previous place of employment. We

operated as a "revenue generating" entity within the university, and set up a system where we could do "service work" for outside clients. By doing this we also had to charge our own users. We set inside rates to a reasonable level so as not to discourage research, and the industrial rates equal to or higher than other service labs in the area were charging so as not to compete with them.
we stayed legal
2) ethical
this topic was much harder to define as to yes/no. there is a lot of gray area out there. I was managing a electron microscopy cost center "revenue generating facility" within the university, at a previous place of employment. I agree with the philosophical argument, "to combine the knowledge and resources of academia with the resources $ available in industry, to solve practical problems and develop new technologies". BUT there there are some very tough proprietary questions which need to be dealt with in advance. Reasonable rates need to be established for faculty and grad students so as not to discourage use, and higher rates need to be established for the industrial clients, so there are no charges of unfair competition from service labs in the area. Then there must be some way of enforcing such policies on "tenured faculty" who may get lost in this grey area "fog $$$".
Faculty sometimes had the idea that consulting jobs could be done at the lower rate, or charged to their grants! This was very hard to monitor and/or enforce, it relies on personal integrity of all those who are using and administrating the facility.
good luck
-Mike

industrial customers, . However, they must not compete directly with laboratories in the private sector. Government-funded research instruments can be used only if the work can not be performed by a commercial lab or if the charge rate is equivalent to or in excess of commercial rates. Proximity, cost and convenience are not acceptable reasons for using a university lab.

* If the lab has received a successful duty-free import application for an instrument within the previous seven years, the instrument must not be used for commercial work. If it is used, duty becomes payable at once in full.

* Work done for industry should not interfere with the mission of the university. (This is one of the few ethical considerations received)

* A two-tiered fee structure is common for universities. A reduced fee is charged to university types and higher fees are charged to industrial customers.

* It is apparently legal to sell university services at the University of Florida to private clients as long as intrastate commercial lab fees aren't undercut. Out-of-state commercial operations are often undersold.

* At the University of Missouri, consulting with in house instrumentation is permissible if there is no conflict of interest.

* Some universities include consulting fees in the instrument rate. This increases the rate above commercial lab fees.

* University Officers at the University of Michigan mandate that university labs help industry in Michigan, where possible. The university also tells campus labs not to undercut private EM consulting labs.

* Argonne National Lab (Material Science Division) received all current instrumentation duty-free. They indicated on their grant application that instruments would be used for research purposes only. This precludes any commercial work.

* The HV EM facility at Wadsworth Center (New York) can have for-profit customers, however, the State of New York cannot legally give any for-profit company any services and cannot make a profit from the services. Charges are calculated on the basis of the costs of utilities and employee salaries.

* One faculty person said that his university can accept grants from the private sector for performing research. The charges are paid in the form of gifts or donations to a foundation which pays the bills.

COMPETEA.TXT Friday, July 12, 1996 3:16 pm

From: PO2::"GVKM07A@prodigy.com" "DR CHARLES A GARBER" 21-JUN-1995 17:15:58.34
To: MICROSCOPY@AAEM.AMC.ANL.GOV
CC:
Subj: Legal/Ethical Questions for listserver

-- [From: Charles A. Garber, Ph. D. * EMC.Ver #2.10P] --

In response to the original posting by John Wheatley and the replies by others now totalling seven:

Everyone answering thus far has been employed by some major research university, in charge of major tax-payer funded instrumentation, in most instances, granted by the federal government, probably on an NSF grant of one type or another (or in some cases, NIH). I now enter the foray, not as a university faculty or staff member but as an owner of one of those "service" laboratories referenced on more than a few occasions. Just for the record, Structure Probe in an independent laboratory offering laboratory analytical services to clients primarily in industry. I am rather proud, in fact of what I did in 1970: With private capital I risked everything that I had in this world and against the advice of just about everyone who knew me at that time, purchased the very first JEOL JSM U3 imported into the USA. My intent was to offer a laboratory analytical service based on this new SEM. Not one drop of government money, federal, state or otherwise, was used in the formation of my firm. This "risk" investment also created jobs, virtually from the very beginning, several of them of the higher paying technical professional type.

And from this "seed" SEM, the company has grown to include the SPI Supplies division and a work force of about 25 persons, many of them highly trained professionals in the EM field.

I am personally astonished with the way one can rationalize as being acceptable what is fundamentally an improper if not outright illegal activity. This is nothing new to me since I have had to deal with this "problem" now for over twenty five years. I have been invited to testify on five different occasions before various committees of the United State Congress to explain what it is like to be a small business person in the United States and have as your main competitors organizations who get their equipment given to them for free on a grant, pay no corporate net income taxes at the federal, state, or local levels, are free from their state's sales and use tax act, can import equipment duty free, just to name a few of the unfair advantages. So far I have not heard one single person say one word about the fairness of it all. I have heard only that if the university charges "commercial rates" then all will be OK and perceived to be "fair".

COMPETEA.TXT Friday, July 12, 1996 3:16 pm

From: PO2::"jjerome@isnet.is.wfu.edu" "Jay Jerome" 22-JUN-1995 09:51:55.7
7
To: Microscopy Forum <microscopy@aaem.amc.anl.gov>
CC:
Subj: Re: Legal/Ethical Questions for listserver

Charles-
I would be very interested in receiving a copy of your posting. I will supply it to our legal people here. For the time being, however, their interpretation differs from yours.
As for the ethical issues. At many Medical Schools these days, we as directors of laboratories are essentially independent entrepreneurs. My laboratory only remains open as long as it generates enough capital to pay the salaries and fringe of my technical people, service and operating costs of my microscopes, and that portion of my time required to run the facility. If this does not occur, I will be shut down. It is the same with all of our support facilities (NMR, Flow cytometry, etc.). That is the

reality of the world these days. That I accomplish this using a mixture of hospital service, grant support (many small businesses also use government grants and contracts), and service to in-house and outside is irrelevant as long as what I charged for that work represents fair cost for doing the work. If I use University of Government money to pay the service contracts and use the benefit to undercut prices THAT IS UNFAIR, UNETHICAL, and ILLEGAL. If I generate business because I am close to the user, have expertise he requires, or because he trusts my product more than a competitors- that seems to me to be fair competition. As long as the playing field is level I see no reason not to offer service to the outside community. We don't do a lot of it, but what we do is important to the financial well being of my facility. After all, many small businesses regular try to get me to use them for my cell culture needs or to produce monoclonal antibodies and oligonucleotides in direct competition with our In-House tissue culture laboratory and probe generating facilities.

Jay Jerome


```
*************************************************************
* aka: W. Gray Jerome                                       *
* Dept. of Pathology                                        *
* Bowman Gray School of Medicine of Wake Forest University  *
* Medical Center Blvd                                       *
* Winston-Salem, NC 27157-1092                              *
* 910-716-4972                                              *
* jjerome@isnet.is.wfu.edu                                  *
*************************************************************
```

placing the burden on the tax payers to buy the equipment and performing th
is
"consulting service"???

-Mike

Entrepeneurs are not the only gamblers; loyalty to a public facility can be just as much of a gamble - moreover, ethics has nothing to say about which type of gamble is morally superior!

This note has been composed on personal time on a personally owned computer with public domain software...
--Jon

Jon L. Norenburg <norenbur@onyx.si.edu>
Invertebrate Zoology - MRC 163
National Museum of Natural History
Smithsonian Institution, Washington, DC 20560
Voice 301-238-3508, Fax 301-238-3361

to me, that this discussion is more about cupidity than anything else. Ethics is an important topic, but, like wrapping oneself in the flag, there is often a temptation to simplify it for the sake of making debating points.

Not all things are well understood just by looking at the "Market Price". After all, Chuck often contributes to our discussions in a helpful manner but surely he doesn't suppose that his email connection fee actually covers the cost of sending his thoughts to the hundreds of members of this list!

Jim Pawley

**********NEW ADDRESS**********
Prof. James B Pawley, Ph. 608-263-3147
Room 1235, Engineering Research Building, FAX 608-265-5315
1500 Johnson Dr. Madison, Wisconsin, 53706.
JPAWLEY@MACC.WISC.EDU

support themselves even it drags them into creative financing to help them survive.

What's this got to do with the original topic? Simply this. Don't blame problems on how to stay both solvent and employed on industry and entrepreneurs who know the rules they work under and are trying to make a profit. The fault is university administrations who, having succumbed to the lure of big (nonprofit) money in research, are making up rules as they go and are playing corporate games on the backs of their faculties. That's what gets the latter into the ethical/mor al
and legal morass that started this whole thing off. Since the university administrations got this problem going, let them solve it, if they know how. One obvious answer is to have universities stop trying to be money making machines and go back to what they're supposed to do, be institutions of learning. I don't think this is likely to happen soon.

Edmund Glaser, D. Eng.
Dept. Physiol.
Univ. Md. School. Med.
Baltimore, MD 21201 USA
Ph: (410) 706-5041
Fax: (410) 706-8341

supported research instrumentation or facilities to provide services for a fee in direct competition with private companies that provide equivalent services."
- For example, "A small firm ... asks a university within a half-day's drive to perform a surface analysis on experimental material. The specimen is fragile or perishable and must be hand carried. The work will require one hour of instrument time. No repeat is expected. The nearest comparable commercial instrumentation is approximately the same distance away. The university should decide to refuse the request of the small company."
- "In considering whether equivalent services are available on a commercial basis in the United States, a facility or instrumentation operator should assure that a reasonable search had been conducted for such services in the commercial market."
** I want to comment that the market for analytical services is national and international. It is not sufficient to survey the availability of comparable services in your city alone. I assert this because my company serves clients all over the US, in Europe and in South America. And I have lost business to university competitors in instances in which the specimens were shipped 2000 miles.

[BTW, I understand that NSF publications such as Notice 91 can be obtained by faxing your request to 703-644-4278 or emailing to pubs@nsf.gov]

In the research area, it is particularly important that universities continue to carry out long-term research, because other organizations are no longer committed to that activity. I think that universities should have a strong claim to funding for basic, long-term research. I know numerous professors who share my objection to university-provided analytical services. Why do they feel this way? Because these activities weaken the university's appeal for public funds.

I am sympathetic to the plea of the facility operator whose dean has issued the edict: "raise money or you lose your job". What I suggest is that you educate your dean to the fact that commercial activities by a small unit of the university (your facility) will harm the university as a whole, and probably the harm will be greater than the short-term gain. (I am also sympathetic to the notion that deans can't be educated, but this doesn't mean you should not try.)

Finally, before we argue further, let us thoughtfully consider what areas of common interest we share as working microscopists, whether we work in the university or in a for-profit organization. I suggest we begin with the following:
- We are all interested in advancing our profession, so that we will

THE UNIVERSITY OF UTAH

ATTACHMENT #4

3416 Henry Eyring Building
Department of Chemistry
Salt Lake City, UT 84112
beebe@chemistry.chem.utah.edu
801-581-5383 phone
801-581-8433 fax
12 May 1995

Dear Colleague,

I would appreciate your help in publicizing the availability of the position of a *Surface Science & Optical Spectroscopy Senior Engineer*, described in more detail on the enclosed advertisement. The ad will also appear in *C & E News* and *Physics Today*. This person will oversee the operation of a new facility with several new and exciting instruments, the most significant of which will be an imaging ESCA spectrometer with 1 μm spatial resolution and better than 0.28 eV energy resolution. Feel free to post the ad. Thanks for your help.

Sincerely,

Thomas P. Beebe, Jr.
Assistant Professor of Chemistry
NSF National Young Investigator, and
Camille Dreyfus Teacher-Scholar

enclosure Advertisement

Department of Chemistry
Henry Eyring Building
Salt Lake City, Utah 84112
Phone: (801) 581-6681
FAX (801) 581-8433

PRA

PAINT RESEARCH ASSOCIATES LABORATORIES INCORPORATED

PRA Analytical Services

✓ Complete Coatings Analysis
✓ Deformulation / Characterization
✓ Paint Failure Analysis
✓ Consulting / Expert Witness

Mark Hedstrom
Group Leader
Analytical Services
430 West Forest Ave
Ypsilanti, MI 48197

Phone (313) 483-3401
Fax (313) 483-0085
Toll Free (888) PRA-9000

ATTACHMENT #5

May 20, 1996

Dr. Donald Chernoff
Advanced Surface Microscopy, Inc.
6009 Knyghton Rd.
Indianapolis, IN, 46220-4955

Dear Dr. Chernoff:

Established in 1943, Paint Research Associates Inc. specializes in serving the needs of the coatings, paint, and polymer industries. Our Analytical Services Division provides *comprehensive chemical analysis of your coatings, paints and polymers*, through our skilled analytical chemists, who have over 30 years combined experience.

Services include complete coatings analysis, deformulation, R&D support, failure analysis, and quality assurance. We also provide expert witness testimony, court depositions, and consulting services in our areas of expertise.

Our Analytical Services Division resides in a modern, fully equipped 8,000 square foot laboratory located on the campus of Eastern Michigan University. With the resources and academic environment of Eastern Michigan University, and our private staff of coatings analysts, we can provide the best of both worlds...cutting edge understanding of new coatings and polymer technology as well as a practical approach to help those involved with paint and coatings to be able to solve their problems. We have the latest analytical instrumentation to help us in our mission, **"To provide our customers with high quality, reliable, cost-effective analyses of coatings, paints and polymers, and to do so in a way that maximizes personal service and helps our customers interpret the results".**

Attached is a brochure describing our services in more detail. If you have any need for our services, or any questions, please call us toll-free **(1-888-PRA-9000)** to discuss your needs.

Sincerely,

Mark Hedstrom, Group Leader
Analytical Services Division

Dr. Kenneth H. Brown
Executive Director

430 WEST FOREST
YPSILANTI, MI. 48197
313/483-3401
fax 313/483-0085

Typical Coatings Analysis

- Separation of a paint into pigment, binder and solvent fractions
- Identification of pigment fraction using FTIR, XRD, EDXA, and wet chemical methods
- Identification of volatile fraction using GC/MS, GC/TCD and GC/FID
- Identification of binder fraction using FTIR and PY/GC/MS
- EPA Method 24 Volatile Organic Content including weight and volume non-volatile, weight per gallon, and water content by Karl Fischer or GC
- Specialty analysis include Acid, Hydroxyl, Epoxide, Iodine, Saponification, Isocyanate, Nitrogen, Peroxide, and Amine values.

Affiliations

Federation of Societies for Coatings Tech	FSCT
American Society for Testing Materials	ASTM
American Chemical Society	ACS
Society of Applied Spectroscopy	SAS
Steel Structures Painting Council	SSPC
International Aerosol Congress	IAC
National Paint and Coatings Association	NPCA
American Society of Quality Control	ASQC

- ✓ *Complete Coatings Analysis*
- ✓ *Characterization*
- ✓ *Deformulation*
- ✓ *R&D Support*
- ✓ *Paint Failure Analysis*
- ✓ *Expert Witness and Testimony*
- ✓ *Consulting*

Introduction

Paint Research Associates Inc. was founded in 1943 as an *independent* research facility to serve the needs of the Coatings and Polymer industry. Originally housed in Chicago, PRA now resides on the campus of Eastern Michigan University, sharing modern facilities with both the Coatings Research Institute and the National Science Foundation. The use of sophisticated analytical instrumentation combined with over 50 years of Coatings and Polymers experience enables PRA not only to provide their clients with raw data, but to work with the client towards the goal of meaningful results. PRA's clientele include not only coatings' producers and raw materials suppliers, but the end users as well. From the contractor to the home owner PRA provides each client with a *confidential*, unbiased report.

Characterization & Deformulation

Perhaps the major benefit in choosing PRA comes from PRA's expertise in the characterization and deformulation of all types of coatings and polymers. Solvent, water-borne, and powder coatings are routinely analyzed as well as their respective raw materials. Samples are characterized with the latest instrumentation including FTIR, GC/MS, GPC, HPLC, DSC, etc. Spectral libraries containing some 3,000 ingredients commonly found in coatings as well as over 130,000 organic compounds are utilized to aid in identification of samples.

Paint Failure Analysis Expert Witness

PRA provides paint failure analysis in which a systematic approach is used. After initial consultation, samples are examined using visible microscopy, SEM, TEM, EDXA, FTIR microscopy, and Pyrolysis/GC/MS. The conclusions drawn from a failure analysis by PRA are supported by providing expert witness and testimony.

ATTACHMENT #6

COMPARISON OF EM USER FEES FOR SELECTED SERVICES, March 1996

	Central EM Facility, UConn	U Mich Sch of Dentistry	U Florida EM Core	U Hawaii, Pac Biomed Res Ctr
TEM, SEM use, per hr				
University	50.00	30.00	25.00	32.00-36.00
Industry	50.00	100.00		
Ultramicrotome use, per hr	10.00			6.00
Sample preparation				
Complete TEM	110.00	150.00	75.00	
Fixation and embedding	30.00	10.00	25.00	
Thin sectioning	50.00	12.50	25.00	
Grid staining	(included in above)	10.00		
Complete SEM, biological	120.00		75.00	
Specimen prep only	50.00	40.00		
Complete SEM, non-biol	80.00			
Specimen prep only	30.00	20.00		
Negative stain (complete)	50.00		40.00	
Negative stain (prep only)	20.00			
Freeze fracture (prep only)	100.00			
Freeze fracture instr use/hr				
EM technical help/hr				25.00

	Ohio State U Elect Optics Fac	JHU Earth & Planet Sci	Rutgers Marine & Coastal Sci	U Missouri Rolla
TEM, SEM use, per hr				
University	15.00-35.00	35.00	35.00	75.00
Industry	90.00-200.00			
Ultramicrotome use, per hr				
Sample preparation				
Complete TEM				
Fixation and embedding				
Thin sectioning				
Grid staining				
Complete SEM, biological				
Specimen prep only				
Complete SEM, non-biol				
Specimen prep only				
Negative stain (complete)				
Negative stain (prep only)				
Freeze fracture (prep only)				
Freeze fracture instr use/hr				
EM technical help/hr	25.00		20.00	25.00

	EPFL-CIME Lausanne, Switz	Trent U Ontario, Can	U of Turku Finland	Univ Med Sch Debrecen, Hung
TEM, SEM use, per hr				
University	20.00	10.00-15.00	17.50-44.50	
Industry	*300.00-500.00			
Ultramicrotome use, per hr				
Sample preparation				
Complete TEM				(w/o photo) 7.00
Fixation and embedding			3.25	
Thin sectioning			(per grid) .75	
Grid staining				
Complete SEM, biological				
Specimen prep only				
Complete SEM, non-biol				
Specimen prep only				
Negative stain (complete)				
Negative stain (prep only)				
Freeze fracture (prep only)				
Freeze fracture instr use/hr				
EM technical help/hr	110.00			

*includes operator

Compiled by Dr. Arthur R. Hand, Central EM Facility, University of Connecticut Health Center

ENEFITS PROVIDED FOR INDUSTRIAL ASSOCIATES

Information is provided on a regular basis concerning the Center, its programs and publications.

Information is provided on a regular basis concerning electron microscopy and associated techniques, recent advances and relevant literature.

Information will be provided on request concerning specific topics in electron microscopy: literature surveys, advice on instruments, techniques and the capabilities and limitations of techniques and procedures.

Visits to the Center and demonstrations of particular techniques.

Anendance at annual Center School (1 representative) and Workshop (2 representatives) at no cost to the Associate. Attendance at special HREM-IAP workshops Notices of weekly seminars, conferences and special events

Assistance with use of equipment and personnel of the HREM Center in accordance with established procedures.

a) Help in matching microscopy techniques and methods to solving microstructural materials problems.

b) 120 hours use of the Center's electron microscopes and other equipment per year with provision for extension if needed.

c) Consultancy arrangements in relation to Center projects or non-Center projects may be possible by private agreement with ASU Faculty and Center Staff. Assistance will be provided in establishing contacts for this purpose by the IAP Manager.

d) Visits by personnel from Associates for the purpose of carrying out research in the Center will be expedited by the IAP Manager.

ORGANIZATION

HREM-IAP is associated with, and established for the benefit of, the ASU Center for High Resolution Electron Microscopy.

The HREM-IAP is governed by a Committee with a majority of the members elected from the Management Committee of the ASU Center for HREM

Associates will have at least one representative on the IAP Management Committee to be elected by the Associates.

The Manager has wide experience in electron microscopy research and will provide liaison with the leading specialists in various areas of HREM who are associated with the HREM Center. The Manager of the HREM-IAP serves as the main contact and provides information and services for the Industrial Associates

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For further information contact:

Dr. Peter A. Crozier
Center for Solid State Science
Arizona State University
Tempe, Arizona 85287-1704

Tel 602 965 2934
Fax 602 965 9004

ATTACHMENT #7

[redacted]

15/SA
8/94

Smith, sample prepared by Allied-Signal Aerospace Company Garrett Auxiliary Power Division)

High Resolution Electron Microscopy Industrial Associates Program

INTRODUCTION

The Center for High Resolution Electron Microscopy, within the Center for Solid State Science at Arizona State University, provides a service to the scientific community through education and assistance in many aspects of high resolution electron microscopy (HREM) and related techniques. In 1988 an Industrial Associates Program (HREM-IAP) was established in the field of high resolution electron microscopy to promote interaction between academic and industrial scientists with interests in HREM.

On the cover
Intergrowth of novel TiO₂ polymorph in naturally occurring anatase mineral (Courtesy of I. Banfield)

AIMS

The HREM-IAP is a means of providing for the mutual benefit of high-tech industrial companies, which have sizable investment, and continuing interest in the use of high resolution electron microscopy, and related techniques, and the Center for High Resolution Electron Microscopy at ASU.

The Industrial Associates will be kept abreast of current developments at the Center and in electron microscopy in general.

The Industrial Associates will be provided with advice and guidance in their use of electron microscopy and assisted in research programs which involve related techniques.

The Center will benefit from increased contact with industrial scientists and better awareness of their current problems and concerns.

United States House of Representatives
Committee on Small Business

My name is Philip C. Hanson, Vice President of The C.H. Hanson Company. I am currently in charge running our Texas plant at 220 West Parkerville Road, Desoto, Texas 75115. The company's main offices are in Franklin Park, Illinois.

We have historically been in the business of manufacturing and selling stencils, particularly adjustable brass stencils, with a large portion of our work being sold to the government. We have also branched out into other areas such as metal identification tags, steel hand stamps, and a variety of safety tapes and signs. Our connections with the federal government go back to the civil war, when my great-grandfather founded the business after being mustered out of the Union army with wounds from the Battle of Gettysburgh.

I've appeared before this Committee today to discuss the federal program which removes government contracts from public bidding and gives them on a monopoly basis to certain workshops for the disabled. I would like to explain how this program almost destroyed The C.H. Hanson Company, and to ask that you consider some of the other ways Congress might achieve the goals it hoped to achieve when it created this law. My suggestions would help everyone involved by maintaining public competition, increasing handicapped employment, and saving the government hundreds of millions of dollars.

The program in question is the one created by the Javits-Wagner-O'Day ("JWOD") Act, which appears at Title 41, Sections 46-48c of the United States Code with related regulations at Title 41, Sections 51-1 through 51-10 of the Code of Federal Regulations. The JWOD Act is administered by an agency called the Committee for Purchase from People Who are Blind or Severely Disabled ("CFP"). Beverly Milkman is the Executive Director of the CFP.

This legislation originated in the late 1930s, long before the Americans with Disabilities Act, or even the change in attitude which led to the passage of the ADA. In the 1930's, blind people had to overcome a common belief that they could not compete in the "real" world. The public were therefore "warehoused" disabled people in nonprofit half-way houses where they could be kept busy with make-work. This odd set of historical circumstances resulted in "workshops" cornering the market on the manufacture

of mops and brooms, items made by hand at that time. The workshops were so desperate to keep people busy that they started to undercut each other in their bids for federal contracts. Congress decided that the country could do without taking advantage of the blind, and it passed the JWOD Act to fix the problem. The program was expanded in 1971 to include the severely disabled as well.

The basic idea was to set up an independent agency, the CFP, to identify and add to a "Procurement List" those items which the workshops were battling each other to sell, to allocate those contracts in a fair way among the different bidders, and to set a "fair market price," *i.e.*, a price equal to what the workshops would receive in the absence of their ruinous mutual competition. Two non-governmental agencies, National Industries for the Blind ("NIB") and National Industries for the Severely Handicapped ("NISH") act as central brokerages for items on the Procurement List.

As shown in the legislative history *[See Attached Exhibit No. 2]* Congress *expressly* wanted to avoid thrusting these workshops into competition with private industry. The problem we face today arises from the fact that the program has grown to include more than $675 million of annual sales of goods and services, almost all of which had been provided by private industry, and most of which were small businesses like The C.H. Hanson Co. My company provides a good example of how much damage this program can do and how unfairly the CFP goes about inflicting that harm.

As I mentioned above, the core of our business since the Civil War has been the manufacture and sale of interlocking brass stencils to the federal government. At times it's made up as much as 30% of our gross sales, and it has always provided the volume we've needed to manufacture efficiently for the private market. Suddenly and without warning, the JWOD program took that business away forever a year and a half ago, assigning it on a monopoly basis to a workshop that still hasn't been able to perform. This happened despite the fact that we already employed a workshop near our Illinois plant to help with this contract.

When we tried to move our business over to related products, like identification tags, we discovered that the CFP had already set those contracts aside also, and the government would therefore accept no bids from private industry. Most recently, we have spent tens of thousands of dollars gearing up to bid on a contract for surveyors' flagging ribbons only to discover that the CFP now plans to set those aside as well in the

near future.

As I understand it, the program works like this. First, NIB or NISH to identify an item or service which a workshop might be able to supply to the federal government. They spend a year or two preparing a packaged proposal and then ask the CFP to add the item to its Procurement List. The item then disappears from competitive procurement as soon as the current contract expires. NIB and NISH are non-governmental entities. Their actions are not open to public scrutiny, and they do their best to keep their activities secret from the businesses in question. They receive an ongoing 4% cut of all contracts they can get added to the Procurement List, so they have every reason to avoid warning current contractors about their plans.

The CFP could require NIB to warn people, or it could even send a letter itself, but it chooses to do neither. The first hint of a danger therefore comes from the CFP's so-called "published notice," which actually provides no notice at all.

The first problem with the CFP notice is that is it appears in a publication which contractors don't read. The government publishes a newsletter called Commerce Business Daily, which contains nothing but notices about the world of federal procurement. That's where you look to find requests for bids, deadlines, spec changes, and anything else that affects government sales. The CFP, however, uses the Federal Register, which no one in the field reads. Worse, the CFP's filings don't mention contractor names, only national stock numbers. Finally, since the Committee allows only a 30-day comment period, the odds are that even if a company read the notice, it would have no time to prepare a package comparable to the 2-year presentation compiled by NIB or NISH.

So there's no warning whatsoever. You can't know a JWOD set-asid is coming, and you have no way to discover it's happened until you call GSA to find out when to submit your next bid. When they tell you there's not going to be any bid, it's too late to do anything about it.

This is exactly what happened in our case. The CFP filed its notice in November 1992. We found out about it relatively early, in mid-January, 1993, because I called Rosa Bailey at GSA to ask when she expected to issue the upcoming solicitation for bids. She told me there would be no new solicitation because the CFP was removing the stencils

from the competitive market. I'd never even heard of the CFP until then. I called the CFP to complain, and Beverly Milkman told me that although we'd missed our chance to file an official Comment, since the workshop hadn't yet passed a Plant Facilities Inspection we could have 10 days to prepare and send a quick letter outlining how loss of the stencil contract would affect our business. We wrote the letter, contacted our representatives in congress for help, and waited.

We never got an answer, but our contract kept getting extended by GSA. The workshop which the CFP proposed to produce the stencils couldn't pass the Plant Facilities Inspection. In the meantime, we hired a local workshop to handle our packaging work. The CFP took the stencils away a year later anyway and put both us and our local workshop out of the business. As a result of the CFP action, we've been driven from the business with hundreds of thousands of dollars of inventory clogging our warehouse.

In many ways, however, the program has an even stronger impact on the government than on private industry. In our case, for example, the workshop still can't manufacture the stencils on the procurement list. They buy stencils from us instead, and turn around and sell them to the government at a markup. I've heard about cases where the government pays triple and quadruple the market price, although in most cases I've heard that it averages only a 40% or 50% increase. Notably, if the government pays a 50% surcharge, that adds up to about $220 Million of pure waste out of this $675 Million program, even more if you count the fact that workshops don't pay income tax while the businesses they displace do, and that in many cases the workers who were fired by companies which lose their government contracts end up on the welfare rolls.

Ms. Milkman will tell you that prices are only 15% too high (a waste of a little under $90 million), not 50%. But she can provide no back-up for this claim. Without updated bids you have no way to know what the "market" does except to look at some kind of index, and that's guesswork by definition. All we can *know* about this program is that lots more money goes in than value comes out. The exact amount of waste can't be told because it's merged into the "price."

When considering how to fix the JWOD Act, it's important to remember that there is no *person* to blame for these problems; the cause lies in the structure of the program. When you eliminate competition, you get high prices, low quality, poor service, and

inefficiency so bad it's either comic or tragic, depending on your point of view. That's economic law, not villainy. And that's what has happened here. The JWOD Act creates a monopoly, and that monopoly cheats its customers just like any other would. It's just a monopoly whose only customer is the federal government, and which has been in place to muck things up for a more than 50 year run. With the creation of the Americans with Disabilities Act and the change in attitude which it reflects, the JWOD Act is no longer needed. In fact, it contradicts the premise of the ADA that disabled Americans should have the chance to work in private industry rather than in the "warehouses" of the JWOD era.

Fortunately, several easy fixes are available. The most obvious option would be to simply repeal the JWOD Act in its entirety. If Congress wants to keep an incentive to employ the handicapped in procurement law, we ask that you consider the legislative proposal which is attached as Exhibit No. 3. Briefly, the proposal would eliminate the mandatory set-aside aspect of the program in favor of a bid-advantage system. Any bidder which hires a sufficient number of disabled workers on a particular project, be it a workshop or a business, would receive a bid advantage of up to 10%. That would limit the government's exposure to excessive prices while at the same time incorporating a market discipline.

This proposal would obviously help the disabled to a far greater extent than the current JWOD Act ever could. The revised system would give businesses a reason to seek out disabled workers to get the bid advantage. That would in turn help people escape from the workshops and into real, taxpaying jobs. Moreover, when disabled people prove they can really do the job, the program will have a multiplied effect by opening the gates of the company to other disabled workers. The current system provides the opposite incentive; no one wants to hire workers with disabilities when the fact that you've done so could lead the CFP to take your business away.

As to the workshops, if Ms. Milkman is right about the current markup a change to the proposed bid-advantage approach will have no effect since the workshops will use the bid advantage to win the same contracts they already have. The workshops will actually enjoy a bigger advantage than just the 10% provided by the proposed statute because they don't have to pay either the minimum wage or income taxes. The workshops therefore can't lose any contracts except those which have been unjustifiably kept on the Procurement List to begin with, those where the government has been getting

overcharged.

Thus the only interests which might suffer are NIB and NISH, and that will only happen if they've been overcharging the workshops until now. Under the current law NIB and NISH receive a 4% broker's fee on all contracts which the CFP maintains on the Procurement List. If they're worth that fee, the workshops will continue to pay it to retain the help of NIB and NISH in preparing bids. If 4% is too high, NIB and NISH could lose some money when the workshops revolt. But other than that, I don't see how anyone can lose. Even NIB and NISH should be helped in the long run if they are forced to deal with market realities.

That completes my testimony. Thank you for letting me appear today.

Statement by
THE HONORABLE EVAN J. KEMP, JR.

Presented to
The House Committee on Small Business
2359 Rayburn House Office Building
Washington, D.C.

July 18, 1996

Thank you, Madame Chair. I appreciate this opportunity to present to the committee a point of view which you have not heard today. It is a view which may be surprising to those of you without disabilities. Yet in fact, what I am going to say is a position which is shared by millions of people with disabilities in this country.

I have been an advocate for disability rights for over 30 years. I worked side by side with many other activists during the creation and passage of laws and regulations to guarantee that people with disabilities have the same rights as any Americans. That includes the right to a sound education; the right to enter public buildings; the right to travel freely; the right to apply for and be considered for a job; the right to succeed and, yes, even the right to fail.

Our years of work culminated in the signing of the Americans with Disabilities Act in July of 1990. It was my privilege to sit next to President George Bush as he signed the ADA and said, "Let the shameful walls of exclusion come tumbling down." For the first time in our nation's history, people with disabilities were granted the right, under the law of the land, to be treated without discrimination.

The ADA has empowered us to take the next step: economic independence. We are now entering the work force in increasing numbers. Employers have begun to see the wisdom of hiring people according to their ability to do the job. As we prepare to enter the 21st century, the trend is clear: people with disabilities are taking control of their own lives.

This century began quite differently. People with disabilities were excluded from nearly every segment of society. They were regarded as sick people who could not take care of themselves – physically or economically. They were pitied by the able-bodied world. Programs were developed to take care of their needs, so that those "poor, unfortunate people" would not have to suffer so much. This is what is called the "Medical Model" – treating all disabled people as helpless patients.

The JWOD program is part of the Medical Model, originally created in 1938 to provide jobs for people who are blind. Simple, menial, underpaid jobs, but they at least

provided some employment in an era when employers would not consider hiring a disabled person on his or her own merits. The program was expanded in 1971 to include people with other physical and developmental disabilities.

Times have changed. What began in 1938 as a well-meaning gesture is now, in 1996, one of the last federally-funded vestiges of paternalism and discrimination.

As with many other government programs, JWOD has become a bureaucracy whose real goal is to keep itself in business. One of JWOD's stated missions is to help prepare people for competitive employment and to provide placement services for them. Yet the August issue of the newspaper *One Step Ahead* reports that in recent years only six percent of JWOD workers have moved on to competitive jobs.

In its attempt to keep itself in business, JWOD is keeping the Medical Model alive. That kind of attitude prevents people with disabilities from achieving economic independence -- which is the goal of all people, disabled or not.

There is even little upward mobility within the program. According to *One Step Ahead,* out of 25,884 workers in one JWOD program in 1995, only 189 were promoted to supervisory positions and 2,222 received other promotions.

There are also serious questions about JWOD's financial dealings. Too much of the money taken in by JWOD goes to administrative costs and not to the employees the program was created to help. Just like other programs designed to "help" minority groups, financial decisions are being made by people who are concerned with their own welfare. In JWOD's case, it is clear that able-bodied bureaucrats are filling their pockets with money that is supposed to go to disabled workers.

Madame Chair, you have heard examples of JWOD's refusal to cooperate with private companies to create real jobs for disabled workers. You have heard how the JWOD "industry" is creating hardships for small businesses. You have also heard that JWOD is not accomplishing the goals it was created to achieve and that JWOD's real goal is its own self-preservation.

I submit that JWOD in its current form has outlived its usefulness. The days of sheltered workshops should be over. The vast majority of people with disabilities can and ought to compete for jobs along with all Americans. And small businesses should be able to compete for government contracts without fear of undue government interference.

I urge you, Madame Chair, and all members of Congress to take a long, hard look at JWOD and remember that people with disabilities want to be integrated into society to the best of their abilities.

Congressional Testimony
U.S. House of Representatives Committee on Small Business
Michael Liberman
President, Valley Forge Flag Company
July 18, 1996

Thank you, Madam Chair. My name is Michael Liberman and I am President of Valley Forge Flag Company located in Womelsdorf, Pennsylvania. I am the great-grandson of a Polish immigrant who loved this country and believed it to be truly a land of opportunity. It may sound like a cliche now, but one-hundred-and-fourteen years ago when my great- grandfather began the business that has been passed down through four generations of our family, dreams did come true if you worked hard and played by the rules.

My great-grandfather was proud to be an American and proud to see his son expand the business to make the flags that symbolized his adopted land. Seventy-eight years later, Valley Forge Flag is the flagmaker for the U.S. government, and the history of this country is really Valley Forge's history too.

Our flags have flown on the beaches of Normandy and on the ships at Guadalcanal. It was a Valley Forge Flag on the first moon flight and on the funeral casket of President Kennedy on his final ride home to Arlington Cemetery.

It was our flag that flew over the first official visit of a Chinese premier after détente, and Valley Forge flags will wave in Atlanta's Olympic stadium this summer.

Two weeks ago, we celebrated the beginning of this country and the ideals upon which it was formed. Back then, a revolution occurred because an oppressive government imposed its will on a people who wanted nothing more than to be left alone to build safe and successful lives for themselves and their families. But the government that was created on July 4, 1776 in response to

that oppression, is not the same government today. Today, my business is under siege from the very government that was created to protect it.

To me, Valley Forge Flag isn't just a piece of real estate or a set of financial numbers. It is 400 people -- working men and women -- single mothers, disabled fathers, senior citizens -- people who believe like I do, that we do good work, at a fair price and that we have won government contracts in competitive bidding for more than five decades because we're a good company, and I've got documents to prove it.

But three years ago, I had to tell 50 of those people who had done nothing wrong that they no longer had jobs because their government had taken them away. The JWOD program had notified me that it was taking 20% of my core contract -- over half-a-million interment flags given annually to the families of every veteran in America at burial. A $15 million a year contract our company has won for over 40 years.

With a simple stroke of the pen, my government took away a critical part of my business and changed the lives of those 50 people forever.

I went to my government to protest that the JWOD Act clearly says that, in seeking to provide jobs for people with disabilities, the Committee for Purchase from People Who Are Blind or Disabled [the JWOD Committee], cannot do serious adverse harm to business. But the Committee believes that as long as they don't take more than 20% of a company's total sales, there is no real harm.

I suggest that if the Committee took 20% of Bill Gates' total sales tomorrow, the stock market would quickly teach them a lesson in how to assess economic impact. In the case of Valley Forge Flag, they ignored the issues of cash flow, overall financial strength, debt obligations, capital commitments and most important, they simply dismissed the fate of these fifty hardworking Americans about to be out of a job.

When I protested, my government told me they were doing good -- trying to create jobs for the blind and others with disabilities. So I offered to work with

the Committee, to join their mission by proposing a plan that would have meant jobs for over 200 people with disabilities.

But the JWOD Committee, my government, said no. Instead, my contract went to an outside non-profit organization -- NISH [National Institute for the Severely Disabled] -- that takes 4% off the top of every contract it administers for the JWOD program and then transfers the contracts down to workshops around the country. Last year, NISH and its counterpart for the blind, NIB, took a whopping $27 million off the top from these federal contracts -- contracts now totaling over $678 million -- taken from small businesses many like mine who are struggling to survive. Unfortunately, some have already lost the battle.

And NISH, hardly an uninterested partner, was intimately involved with JWOD in deciding whether taking my company's contract -- a first-year loss of $2.6 million -- was harmful to Valley Forge.

It is no surprise that together they decided to ignore both my protests and my proposal and the protests and proposals of other companies like mine to directly hire disabled workers even though I would have employed dramatically more disabled people under this contract than they did.

Instead, NISH transferred the contract to three sheltered workshops. One workshop was unable to meet its part of the contract. A second sheltered workshop in Huntsville, Alabama subcontracted most of the work -- we think about 90% -- right back to a for-profit company -- a company who happens to be one of my biggest competitors. A company which could not win the contract in competitive bidding but through its relationship with NISH and its satellite workshops -- has it now. The outcome? For $2.6 million in sales, eight people with disabilities got jobs, a fraction of what I would have provided, and fifty working men and women in Pennsylvania lost theirs. This is not how my government should work.

Yet, the JWOD Committee will tell you that it is working just fine. Even though only 21 cents of every dollar in federal contracts taken by JWOD actually ends up in the pockets of the blind and other disabled people as wages. Even

though less than 10 -15% of the labor required for most JWOD contracts is actually done by disabled workers.

Even though the majority of JWOD dollars end up in administrative costs, materials and in the bank accounts of for-profit subcontractors. In the case of Valley Forge's contract, our estimate is that only 4 cents on the dollar went to pay the wages of people with disabilities.

The JWOD Committee also believes, that under their regulations, only 75% of the labor that a workshop decides to keep "in house" must be done by people with disabilities.

One told us that the Committee could set aside a nuclear aircraft carrier if they wanted to, and then a NISH workshop, for example, could subcontract everything but painting the white line down the flight deck. As long as 75% of that line was painted by a disabled individual, they claim, the workshop would meet the requirements of the JWOD Act. This notion not only defies Congressional intent, it defies all logic.

Even with this remarkably creative interpretation, the JWOD Committee has repeatedly criticized the workshops, which received the flag contract, for failing to meet even the required minimum percentage of disabled labor.

This is not how my government should work either. No one is against employing people with disabilities. In fact, I have eleven disabled employees right now. I have tried to work within the system and last January offered a JWOD legislative reform proposal to encourage small businesses like mine to hire disabled workers. This proposal would give private sector small businesses who hire people with disabilities a competitive advantage in bidding for federal procurement contracts.

This proposal would have increased mainstreaming of disabled workers, increased their numbers and at the same time, stopped the severe adverse harm now being done to small businesses across the country by the JWOD Committee. I am hopeful that next year, we may see Congressional action.

Last January, I once again offered a plan to the JWOD Committee to hire more disabled people than were currently being employed by the workshops through the taking of my contract. I told them, "I will triple whatever the number of people with disabilities you say are being employed by this contract. I will give them good jobs and good benefits at wages much higher than the JWOD average of $6.11 an hour, and we will all succeed." The Committee said no again.

Yet, despite the harm already done my company and my employees by taking the first 20% of my contract, despite my sincere attempt at compromise that would have resulted in far more disabled individuals getting jobs, on May 17, the JWOD Committee informed me they intend to take another 20% of my contract for a total of 40%. This will mean a loss to Valley Forge Flag of $6 million for the fiscal 1997 contract and many more millions in the years to come. The fact that I have appealed to members of Congress -- Republican and Democrat -- has not gone unnoticed and apparently will not go unpunished.

To protest this action, at my own expense, I hired an outside financial expert, Siegel Management Company, to assess the impact of JWOD's proposed action on Valley Forge Flag. According to this independent consultant who testified before the JWOD Committee, the loss of the first 20% of the contract would transform the company from a profitable to a loss position.

Moreover, he said the taking of another 20% of this contract would "severely threaten Valley Forge Flag's viability" and likely would be a "knockout blow." He also projected losses of $1.2 million and layoffs telling the Committee that "one would expect VFF to eventually cease operations." Given these circumstances, the JWOD Act clearly prohibits the Committee's proposed taking of my contract, but so far the Committee has simply ignored the law.

I am not trying to put JWOD out of business. But, they should not be allowed to put me out of business either. The administration of the JWOD program is riddled with conflicts of interest. There is no oversight and no accountability. Even the disability community itself is very critical of the way this

program operates, but this is a government program that, because of its constituency, has been untouchable.

Valley Forge Flag is not Microsoft or GM. We don't have their kind of money or clout, but I believe we do have right on our side.

I'm not asking you to end this program, but I am asking you to take action to reform it. We all want to help people with disabilities find rich and rewarding lives, but make no mistake, my employees bleed just like anybody else. This government has no right to arbitrarily take their livelihood away even for the best of causes.

If the JWOD Committee is allowed to take this punitive action against my company, this fall I will have to lay off 50 to 70 more workers. Seventy families without jobs or money to put food on the table.

Let me make it clear, if JWOD gets its way, the future of Valley Forge Flag as a company is in doubt. My hope is that my children will have the chance to continue to build the business their great-great grandfather started so long ago and that they, too, will have the opportunity to make their dreams come true.

For almost four years, I have tried to work with the JWOD Committee to save Valley Forge Flag and the jobs of its employees, and I have offered ways to employ more of theirs. I don't want to be an adversary, but I feel I must be an advocate for change. My company is at stake, the future of 400 families is at stake, and I suggest to you that the very ideals of fairness and opportunity upon which this country was founded are at stake, too.

Thank you very much for this chance to tell my story, and I will submit for the record supporting documents and other pertinent information.

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VALLEY FORGE®

FACT SHEET

- Begun by Polish immigrants in 1882, Valley Forge Flag is a family-run business which has passed through four generations and is headed today by the founder's great-grandson, Michael Liberman.

- Upon arrival in New York, Liberman's great-grandfather and his son, Morris, opened a burlap bag business. By 1918, Morris had struck out on his own with $75 in seed money, selling World War I surplus material -- including flags. At the same time, the American "moving picture" business was growing and Liberman Flag and Banner began to provide theater valances. Prominent display of Liberman family products began in 1931 with the debut of the famous "King Kong" banner which hung on the then-new Radio City Music Hall to herald the movie's premiere.

- Despite the Depression, by 1932, Morris' four sons (including Michael's father) had joined the thriving family business. To meet growing demand, they rented a small factory in Spring City, Pennsylvania and Valley Forge Flag was born. The brothers hung a small sign, "Men and women wanted. 30 cents an hour." Five thousand job seekers showed up.

- The Second World War brought unprecedented demand for flags for the U.S. military, and government contracts became Valley Forge's core business. Its flags flew proudly on every battlefront and from the mast of every ship. In fact, the American flag on display in the Museum of the Battle of Normandy is a Valley Forge original.

- To this day, Valley Forge Flag has maintained its position as one of the country's leading suppliers of flags to the U.S. government consistently winning contracts based on a superior product, fair pricing and on-time delivery. In 1991, the company acquired a new facility in Womelsdorf, Pennsylvania. For over four decades, Valley Forge Flag has won competitive bids and contracts from the U.S. Department of Veterans Affairs to provide burial flags for America's veterans and the new factory was designed specifically to meet the increasing demand and exacting standards of these orders.

- Today, Valley Forge Flag employs over 400 working men and women including a number of disabled Americans. President Michael Liberman is active in community and civic affairs having served on various executive committees of the Anti Defamation League of Bnai Brith; the Board of Governors of the Bailystoker Synagogue; and the Alumni Committee of the University of Pennsylvania.

VALLEY FORGE FLAG COMPANY, INC. □ FLAGMAKERS FOR THE U.S. GOVERNMENT
1700 CONRAD WEISER PARKWAY, WOMELSDORF, PA 19567 □ TELEPHONE: 610-589-2400

VALLEY FORGE FLAG PROUDLY SERVING.....

- **OUR NATION'S FIGHTING MEN AND WOMEN**
  From World War II and the Korean Conflict to the Vietnam War, Valley Forge Flag has manufactured virtually every interment flag for the last 50 years. Whether legendary figures like General Omar Bradley and General Lewis "Chesty" Puller or "quiet heroes," our veterans have been laid to rest with Valley Forge flags. In recent history, soldiers who died during the invasion of Panama, Operation Desert Shield, and the U.S. intervention in Somalia were honored with Valley Forge flags.

  During the Persian Gulf War, Valley Forge Flag originated the "Yellow Ribbon" flag which was so proudly displayed in thousands of communities across the nation.

- **AMERICA'S PRESIDENTS**
  Valley Forge flags have also draped the coffins of American Presidents for the last three decades -- Dwight D. Eisenhower, Lyndon Baines Johnson, Richard M. Nixon and John F. Kennedy. Perhaps most poignant, a member of President Kennedy's honor guard wrote a letter to the Liberman family telling of seeing the Valley Forge Flag label on JFK's casket flag as the solemn funeral cortege crossed the Potomac River to Arlington Cemetery

- **THE CONGRESS**
  Valley Forge Flag recently won a contract to provide the flags which fly above the U.S. House of Representatives.

- **U.S. DIPLOMACY**
  In addition to U.S. flags, Valley Forge manufactures the flags of virtually every country on earth. The company is frequently called upon to provide flags to the U.S. State Department for the visits of foreign leaders and the flags are prominently hung along Pennsylvania Avenue and on the Old Executive Office Building.

  During the Nixon Administration, Valley Forge provided ceremonial flags for the historic first U.S. visit of a Chinese premier after détente.

- **ASTRONAUTS**
  Valley Forge's flags were also a part of the first Apollo mission to the moon.

- **VICTIMS OF THE OKLAHOMA CITY BOMBING**
  Michael Liberman donated burial flags for victims of the Oklahoma City bombing in April 1995. He said at the time, "these people were killed in action, so they really deserve official interment flags."

Valley Forge Flag is a staunch supporter of the MADE IN THE USA label.

THE JAVITS/WAGNER/O'DAY (JWOD) PROGRAM

HOW MUCH HELP -- HOW MUCH HARM?

Every year, a little-known federal agency -- the Committe for Purchase from People who are Blind or Severely Disabled (the JWOD Committee) -- takes over $678 million in federal contracts from small businesses across the country putting the companies and the jobs of many of their workers at risk. Why? To give jobs to people with disabilities. But a closer look at this agency raises serious questions about who really gets helped and who gets hurt by this program, created over 60 years go by the Javits/Wagner/O'Day (JWOD) Act; and is anybody, including people with disabilities, really getting a fair deal from this New Deal program?

One of the nation's oldest flag manufacturers, Valley Forge Flag Company, is a typical example of a small business targeted by the JWOD Committee to lose a major portion of its core contract -- a contract won fairly and competitively for over 40 years. Although prohibited by law from causing businesses any "severe adverse harm," the JWOD Committee's actions threaten the viability of Valley Forge Flag and the jobs of 400 working men and women in Womelsdorf, Pennsylvania.

HOW JWOD WORKS

- The Committee for Purchase from People Who are Blind or Severely Disabled, an independent federal agency, sets aside federal contracts for goods and services to be administered by two private, non-profit agencies -- NIB, National Institute for the Blind and NISH, National Institute for the Severely Disabled. The purpose of the program is ostensibly to create jobs for the blind and others with disabilities.

- The contracts are taken from small businesses across the country to the tune of **$678.6 million in 1995** with little or no government oversight although the JWOD Act specifically prohibits the program from doing any serious adverse harm to business.

- Sheltered workshops around the country are given the contracts and pay NIB and NISH a **4% cut on every contract**. That 4% amounted to over $27 million in 1995.

- Despite the fact that the program was created to provide jobs for people with disabilities, the **JWOD Committee does not require workshops to actually do the majority of the work themselves**. The only requirement is that whatever part of a federal contract the workshop chooses to keep, 75% of the work must be done by the blind or the those with disabilities.

- Instead, **workshops often subcontract the majority of the work, as much as 90%,** to private sector, for-profit companies who avoid federal procurement competitive bidding and instead get the contracts indirectly through this convoluted system.

- The program is growing by leaps and bounds with a 24% sales increase for NISH last year and a 14% increase for NIB. Yet **only 21% of NIB/NISH contract moneys actually end up as direct wages paid to blind or disabled workers.**

- The protests of small businesses adversely affected by the program are routinely rejected by the JWOD Committee which only considers one factor in determining adverse harm: what percentage of a small business' total sales the taking of a contract represents. If the taking of a contract is "only" 20% or less of a company's sales, the Committee doesn't consider its action "severe adverse harm."

THE VALLEY FORGE FLAG STORY

- Valley Forge Flag is one of the **oldest flag manufacturers in the country.** It has provided flags to the federal government for decades including code signal flags, U.S. House and Senate flags and its main core contract, interment flags for the nation's veterans which represents 50% of the company's sales.

- In 1993, the JWOD Committee informed Valley Forge Flag, that it intended to take 20% of its core **interment flag contract**, a contract VFF has won in open bidding for over four decades. VFF protested the taking showing serious adverse harm to the company and offering an innovative proposal that would have resulted in over 200 workers with disabilities getting jobs. The Committee rejected the protest and the private/public partnership proposal.

- By its own records, the JWOD Committee gave the contract for the interment flag to three sheltered workshops and created a grand total of **8 jobs for disabled workers.** Meanwhile, Valley Forge Flag was forced to lay off 50 people.

- **Only 4% of the contract dollars went to workers with disabilities. The rest went to NISH administrative costs (also 4%); private sector subcontractor(s) and materials.** One sheltered workshop was unable to meet its part of the contract. A second sheltered workshop in Huntsville, Alabama subcontracted the majority of the flag contract to one of Valley Forge's main competitors, a company who could not win the contract in open and fair competition.

- Also, the **sheltered workshops have been cited** by the Committee numerous times over the past three years for non-compliance -- failing to have even 75% of the work they keep in house done by disabled workers.

- In January, 1996, Valley Forge Flag protested again and offered, in writing, to triple whatever the number of people with disabilities the JWOD Committee claimed were getting jobs through this contract. Valley Forge's offer would have meant these workers would have been mainstreamed and received higher wages and better benefits. Again, the Committee turned VFF down.

- Valley Forge Flag then began efforts to reform the JWOD program itself through Congressional action and contacted a number of Members of Congress and Hill staff. The company offered a creative legislative reform proposal that would have given private sector small businesses who hire people with disabilities a competitive advantage in bidding for federal procurement contracts. This proposal would have increased mainstreaming of workers with disabilities, increased their numbers and, at the same time, stopped the severe adverse harm now being done to small businesses across the country by the JWOD Committee.

- On May 17, the JWOD Committee notified Valley Forge Flag it intended to take another 20% (for a total of 40%) of its contract bringing annual losses to VFF of $6 million beginning with the fiscal 1997 contract. This, after telling its president and several others in a January meeting, that the Committee didn't plan to take any more of the interment flag contract. Clearly, this is a punitive action.

- On June 27, the president of Valley Forge Flag, Michael Liberman, appeared before the JWOD Committee to protest the taking of a second 20% of his contract. He hired an independent outside consultant, Siegel Management Company, to review Valley Forge Flag's financial condition and the impact of the Committee's proposed action on the future of the company. The consultant found that the loss of the first 20% of the contract would transform the company from a profitable to a loss position. Moreover, he said the taking of another 20% would "severely threaten the viability" of the company and called it a "knockout blow;" projected losses of $1.2 million; and layoffs of 50-70 people. There can be no question of "severe adverse harm" to this small company.

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THE JAVITS/WAGNER/O'DAY PROGRAM

HOW MUCH HELP -- HOW MUCH HARM?

1995	NIB	NISH	Total
Annual sales taken from small business (millions)	$247.2	$431.4	$678.6
Product Sales	$243.6	$114.9	$358.5
Service Sales	$3.6	$316.5	$320.1
Direct wages paid (millions)	$19.6	$121.5	$141.1
% of wages going to people with disabilities	8%	28%	21%
Average hourly wage	$5.33	$6.26	$6.11
4% administrative "commissions" (millions)	$9.9	$17.2	$27.1
Number of (fulltime equivalent) people with disabilities employed	1,850	9,700	11,550

Annual Sales	1994	1995	% increase
NISH annual sales	$348	$431.4	24%
NIB annual sales	$217	$247.2	14%
Total JWOD annual sales	$565	$678.6	20%

Valley Forge Flag's JWOD Burden

JWOD wants one small company -- Valley Forge Flag -- to absorb over 5% of NISH's total product sales of almost $115 million.

20% of VFF interment flag contract lost to date	$2.6 million
1996 -97 loss expected by taking proposed second 20% of contract	$6 million
Total NISH sales/ products - 1995	$114.9 million
Valley Forge Flag percentage of NISH product sales	5%

THE VALLEY FORGE FLAG

JWOD BURDEN

JWOD has taken $2.6 million dollars in sales
from Valley Forge Flag's core
U.S. government contract -- interment flags.

50 VFF workers lost their jobs.

JWOD now wants to take another 20%
from VFF's contract
-- a total of $6 million for fiscal 1997.

50-70 workers will lose their jobs this fall
-- entire company will be put at risk.

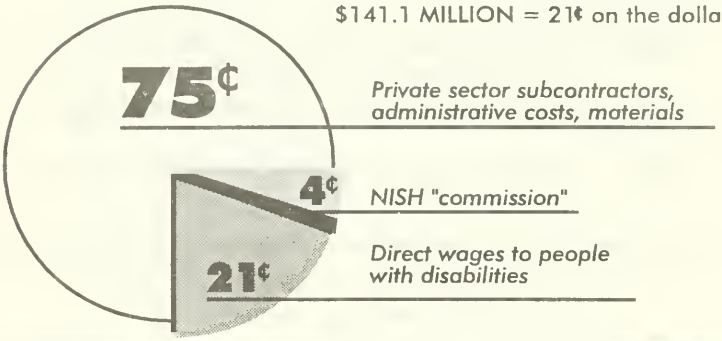
Valley Forge Flag -- one small company
is being forced to absorb 5% of NISH's
total annual product sales of $115 million.

JWOD is threatening the viability of
Valley Forge Flag and if it prevails,
Valley Forge Flag may have to
cease operations.

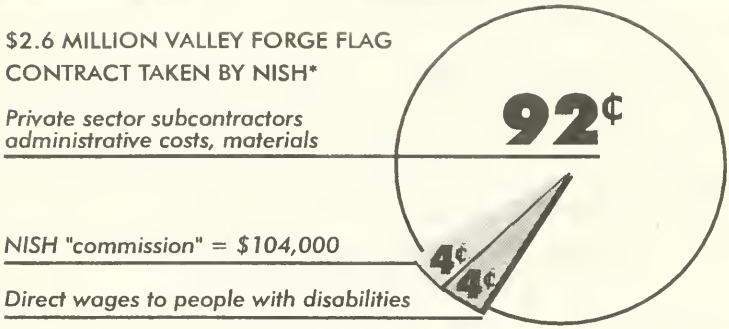
HOW JWOD DOLLARS ARE SPENT

1995 NISH/NIB SALES: $678.6 MILLION

DIRECT WAGES TO PEOPLE WITH DISABILITIES:
$141.1 MILLION = 21¢ on the dollar

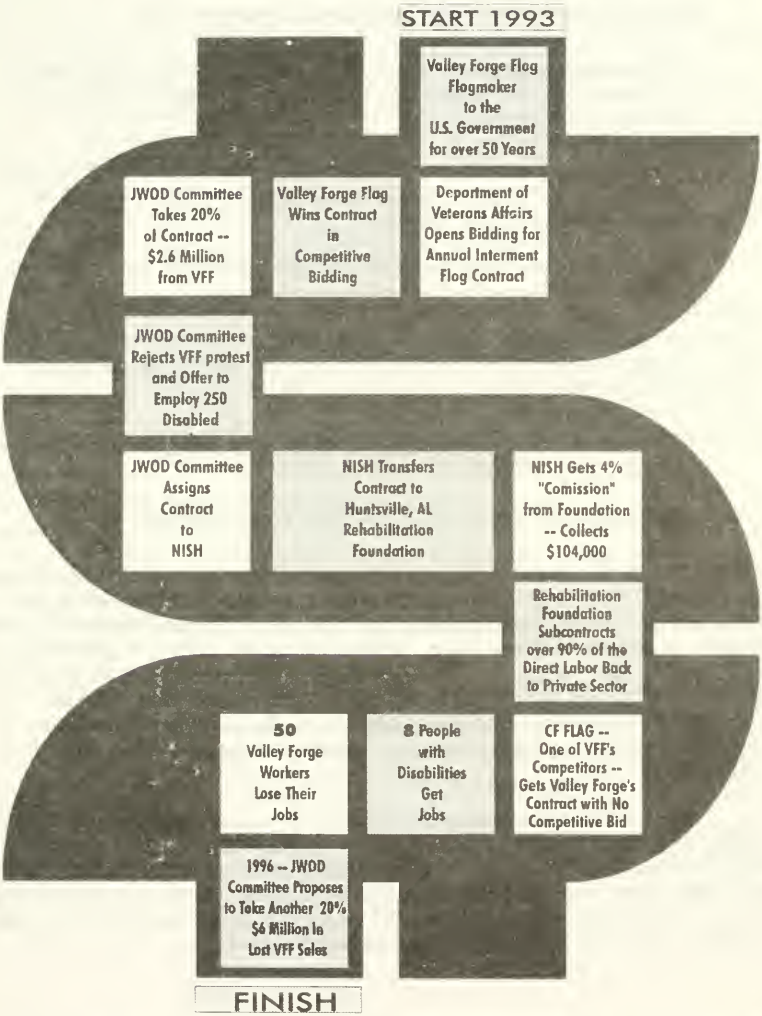


$2.6 MILLION VALLEY FORGE FLAG CONTRACT TAKEN BY NISH*



*Based on initial 20% of 1993 VFF contract

THE JWOD GAME



CF FLAG AND NISH WIN THE JWOD GAME

Legislative Proposal for Improvements to the Javits-Wagner-O'Day Act

I. Goals for Improvements in the JWOD Act

- To eliminate waste in the JWOD program by lowering the cost of goods purchased by the government through the use of competitive bidding and private sector efficiencies;
- To encourage the private sector to provide employment for the blind and persons with other severe disabilities through greater opportunities to participate in the JWOD program;
- To maintain or increase employment of workers who are blind or have other severe disabilities at the same or higher compensation;
- To encourage the development of additional job training and cost effective employment programs in the private sector for persons with disabilities through use of JWOD Act procurements; and
- To consolidate duplicative procurement functions and eliminate incentives to charge the government more for products and services.

II. Introduction to Proposed JWOD Act Improvements

In order to accomplish these goals for improvements in the JWOD Act, changes must be made in the current method of operation to encourage involvement by the private sector in providing employment for persons with disabilities. To do this, private entities must be given a chance to bid. This will introduce competition into this over $565,000,000 a year program and lower costs of procurement for the government. At the same time, awards of contracts to provide commodities and services on the Procurement List must recognize the program's goal of providing employment to persons with disabilities. Incentives must be given to bidders to provide such employment.

The following proposal would provide a strong incentive to private entities (and for that matter to the nonprofit sector) to provide increased employment for persons with disabilities, while preserving the current JWOD program with respect to products in which the private sector does not wish to become involved. To the extent competitive bidding is introduced in an environment that incentivizes employment for persons with disabilities, each goal set forth above can be accomplished.

III. Outline of Proposed JWOD Act Improvements

The JWOD program would remain in place, but would be modified as provided in this outline.

A. Competition and compensation changes

1. Except as described below, commodities or services on the JWOD Procurement List would continue to be procured by Federal government entities from nonprofit agencies employing persons who are blind or have other severe disabilities, if the product or service is available within the normal period required by that government entity.

    a. Subcontracting with for profit entities by nonprofit agencies which receive contracts under the JWOD program could be done only through an open, competitive bidding process.

    b. The compensation paid to persons with disabilities in supervisory positions allocable to the contract would be counted toward the requirement that 75% of the "direct labor" performed by the nonprofit agencies on the contract be performed by persons with disabilities. This would eliminate the JWOD program's current disincentive to promote persons with disabilities (who now, if promoted, do not count towards this 75% "direct labor" requirement).

B. More fairness through competition

1. If (1) the JWOD Committee determines that private industry would be willing to provide a commodity or service on the Procurement List, or (2) the JWOD Committee receives a notice from a for profit or nonprofit entity stating that it is willing to provide the commodity or service, then:

    a. The commodity or service would be placed immediately on a portion of the Procurement List labeled the "Competitive Procurement Section"; and, to the extent that commodity or service otherwise would have been procured under the JWOD program, that commodity or service shall only be procured through the process set forth below.

    b. Such commodities and services would be procured by the applicable agency through the agency's normal procurement process; subject to the modified procedures set forth below.

C. Alternative 1

Modified competitive procurement process -- Award Based on Reduction of Bid Amount for Evaluation Purposes Only

1. All bids submitted for commodities and services on the Competitive Procurement Section of the Procurement List would be required to include the following:

    a. A certification as to the minimum total compensation guaranteed to be paid out of the proposed contract to persons with disabilities;[1] and

    b. A certification as to the minimum number of hours of employment guaranteed to be provided under the proposed contract to persons with disabilities.

2. In evaluating the bids, each bidder's total bid would be reduced by a percentage of the minimum total compensation guaranteed to be paid out of the proposed contract to persons with disabilities. This reduction would be for bid evaluation purposes only; the contract would be awarded at the price bid.

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[1] If the total amount of the procurement is not ascertainable, then the bidder would be required to submit figures based on number of hours of employment and total compensation to be paid for each $100,000 or $500,000 (depending on the expected size of the procurement) paid to the bidder as a result of such procurement. At the time of termination of the contract, the contractor would be required to submit a certification as to the actual number of hours of employment provided under the contract to persons with disabilities and the total compensation paid out of the proposed contract to persons with disabilities. The minimum total compensation would be a contractual commitment to be enforced by the contracting agency in the same manner as is any other mandatory contract term. In addition, failure by a contractor to keep its commitment on this issue would subject it to penalties as described below.

a. Percentage reduction:

If 22%[2] or less of the proposed contract was the minimum compensation guaranteed to be paid to persons with disabilities, then 50% of the total compensation to be paid out to persons with disabilities would be deducted from the bid (for evaluation purposes only).
If more than 22% but 30% or less of the proposed contract was the minimum compensation guaranteed to be paid to persons with disabilities, then 50% of the total compensation up to 22% of the total, and 75% of such compensation over 22% to be paid to persons with disabilities would be deducted from the bid (for evaluation purposes only).
If more than 30% of the proposed contract was the minimum compensation guaranteed to be paid to persons with disabilities, then 50% of such total compensation up to 22% of the total; 75% of such total compensation between 22% and 30%; and 100% of such total compensation over 30% to be paid to persons with disabilities would be deducted from the bid (for evaluation purposes only).

b. Example 1: Assume that Company "A" bid $1,000,000 and promised to provide $200,000 in minimum total compensation to persons with disabilities. This $200,000 figure is 20% of the total bid. Under the formula, $100,000 would be deducted from the bid for evaluation purposes only.[3] This would mean that the bid would be evaluated as if Company "A" had bid $900,000. If Company "A" were the lowest responsive and responsible bidder, the contract would be awarded as bid, i.e. $1,000,000.

c. Example 2: Company "B" bid $1,000,000 and promised to provide $375,000 in minimum total compensation to persons with disabilities. The $375,000 figure is 35% of the total bid. Under the formula, $245,000 would be deducted from the bid for evaluation purposes only.[4] This would mean that the

[2]This figure is derived from the fact that, as noted above, 22% of federal funds under the control of the JWOD program is now paid to persons with disabilities.

[3]The $200,000 figure is 20% of the total bid. Under the formula, 50%of such minimum total compensation (i.e. $100,000) would be deducted form the bid for evaluation purposes.

[4]The $375,000 figure is 35% of the total bid. Under the formula, 50% of the $220,000 (i.e. the amount which is 22% and below of the total bid) would be deducted from the bid. An additional $60,000 would be deducted from the bid, since this represents 75% of the amount of total compensation which is more than 22% of the total bid but equal to or less than 30% of

bid would be evaluated as if Company "B" had bid $755,000. If Company "B" were then the lowest responsive and responsible bidder, the contract would be awarded as bid, i.e. $1,000,000.

d. Under this proposal, companies would receive a significant incentive to increase compensation paid to persons with disabilities.

D. **Alternative 2**

Modified competitive procurement process - Award To Bidder Providing Most Employment To Persons With Disabilities So Long As Bid Is Within A Certain Percentage Of The Low Bid

1. All bids submitted for commodities and services on the Competitive Procurement Section of the Procurement List would be required to include the following:

   a. A certification as to the minimum number of hours of employment guaranteed to be provided under the proposed contract to persons with disabilities; and

   b. A certification as to the minimum total compensation guaranteed to be paid out of the proposed contract to persons with disabilities.[5]

2. The procurement would be awarded to the responsive and responsible bidder who:

   a. bids (I) the lowest price **or** (ii) a price not more than 5% in excess of the lowest bid[6] if the bidder is a for profit entity

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the total bid. Finally, an additional $75,000 would be deducted from the bid, representing 100% of the total compensation above 30% of the total bid (i.e. 100% of $75,000). Thus a total of $245,000 ($110,000 + $60,000 + $75,000) would be deducted from the total bid for evaluation purposes.

[5]The minimum number of hours of employment and minimum total compensation would be a contractual commitment to be enforced by the contracting agency in the same manner as is any other mandatory contract term. In addition, failure by a contractor to keep its commitment on this issue would subject it to penalties as described below. If the total amount of the procurement is not ascertainable, then the bidder would be required to submit figures based on number of hours of employment and total compensation to be paid for each $100,000 or $500,000 (depending on the expected size of the procurement) paid to the bidder as a result of such procurement.

[6]Bids which are not from responsive and responsible parties would be disregarded in making this calculation.

and within 10% if the bidder is a central nonprofit agency and/or a nonprofit agency, as defined by the JWOD Committee in 41 C.F.R. § 51-1.3 (Definitions); **and**

b. has the lowest JWOD Program Value Score, which will measure the benefit of the procurement in terms of employment of persons with disabilities by balancing the number of hours persons with disabilities will be employed with the compensation paid for such employment.

3. Determining the JWOD Program Value Score[7]: To determine the JWOD Program Value Score, the agency procuring the commodity or service would:

   a. Evaluate the bid and rank the bidders from the most hours of employment promised to the fewest hours of employment promised.

   b. Likewise, the bidders would be ranked from the bidder promising the highest amount of compensation paid to persons with disabilities under the proposed contract to the bidder promising the least amount of compensation paid to persons with disabilities under the proposed contract.

   c. The rank (1, 2, 3, etc.) of each bidder with respect to hours of employment promised would be multiplied by 3.

   d. The rank of each bidder with respect to the total compensation promised to be paid to persons with disabilities would be multiplied by 2.

   e. The numbers obtained under (c) and (d) would be added together to determine the JWOD Program Value Score.

4. Attached as Exhibit "A" is an hypothetical example as to how the proposed improvements would work.

E. Qualification of persons with disabilities

1. In order to qualify for participation in the amended JWOD program, persons with disabilities may be employed by either nonprofit or for profit entities, including but not limited to nonprofit agencies currently

[7] The JWOD Program Value Score has been established to give credit to a bidder for both total hours worked and total compensation paid to persons with disabilities. Total hours worked is given a higher priority (3/5) than total compensation (2/5).

authorized to furnish commodities or services under the current JWOD program.

2. In order to have their compensation and hours worked counted in the modified competitive procurement process:

   a. Nonprofit agencies and the employees who are blind or have other severe handicaps must be certified by a central nonprofit agency designated by the Committee ("Central Nonprofit Agency"). Currently NISH and NIB are the central nonprofit agencies

   b. Individuals employed by for profit companies must be certified as being blind or having another severe handicap by a Central Nonprofit Agency.

3. The Committee, by regulation, would be required to provide for the certification process.

   a. The certification process would involve initial certification and subsequent monitoring to insure continued eligibility to be included in the JWOD program.

   b. Central Nonprofit Agencies would not be permitted to discriminate between nonprofit agencies and for profit companies in performing certifications.

   c. The Committee would be authorized to designate additional Central Nonprofit Agencies with authority limited to conducting the certification process.

   d. Each Central Nonprofit Agencies would be required, by contract, to follow the Committee's procedures. Failure to follow Committee procedures would be grounds for the Committee to revoke designation of an entity as a Central Nonprofit Agency. The Committee would be obligated to investigate complaints by other government agencies, bidders and contractors with respect to the performance of Central Nonprofit Agencies.

4. Compensation of the Central Nonprofit Agencies for performing such certification services would be set by the Committee so as not to exceed the reasonable cost of the Central Nonprofit Agency in providing such certification services; provided, however, that in no event would the cost of such services exceed 1/2% (.5%) of the total amount of the contract. Compensation for such services would be

paid by the appropriate bidder or contractor directly to the Central Nonprofit Agency.

F. Reports by contractors

1. Every 6 months and at the time of termination of the contract, each contractor would be required to submit a certification as to the total compensation paid out of the contract to persons with disabilities and the actual number of hours of employment provided under the contract to persons with disabilities.

2. Reports would be made to the contracting agency and to the Committee. The Committee would be required to submit a copy of each report to each Central Nonprofit Agency.

3. Reports would be public records.

G. Penalties[8]

1. If the head of the contracting agency determines that (a) a contractor has not provided the minimum total compensation guaranteed to be paid out of a contract to persons with disabilities or (b) a contractor has not provided the minimum hours of employment guaranteed to be provided under the proposed contract to persons with disabilities, the head of the contracting agency would be required to assess a penalty against the contractor in an amount equal to:

   a. the higher of (I) the amount equal to the difference between the guaranteed total compensation and the amount of actual compensation paid under the contract to persons with disabilities; or (ii) the amount equal to the difference between the guaranteed minimum hours of employment and the actual hours of employment multiplied by the average hourly compensation paid to persons with disabilities by that contractor on that contract; plus

   b. interest (to be computed based on provisions in the Federal Acquisition Regulation) to compensate the United States for the use of any funds set forth in (a) above.

2. The Federal Acquisition Regulation would be required to provide for a penalty to be waived in the following instances:

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[8]This concept is based on 10 U.S.C. § 2324(b) and § 2324© and the regulations promulgated pursuant thereto.

a. if the difference between the guaranteed total compensation and the actual compensation paid were insignificant, or

b. If the difference between the guaranteed minimum hours of employment and the actual hours of employment were insignificant.

3. These penalties would be in addition to other administrative, civil, and criminal penalties provided by law. It is expected that the minimum number of hours of employment and minimum total compensation would be a contractual commitment to be enforced by the contracting agency in the same manner as is any other mandatory contract term.

IV. Conclusion

By adopting this proposal, the JWOD Act would be preserved, but many of its inefficiencies would be corrected. Employment of persons with disabilities would continue to be encouraged for procurements of commodities and services on the JWOD Procurement List. However, the costs of the program will tied to the actual market value of the products purchased by the government and the private sector will be encouraged to become involved in providing employment through the JWOD program. It is believed that these proposals not only will save the government money but also will end up providing more and better employment for persons who are blind or have other serious disabilities.

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DIRECT DIAL NUMBER:

215-569-5534

June 21, 1996

VIA FEDERAL EXPRESS

Ms. Beverly L. Milkman
Executive Director
Committee for Purchase from the Blind
and Other Severely Handicapped
Crystal Square III, Suite 403
1735 Jefferson Davis Highway
Arlington, VA 22202

RE: Proposed Addition of an Additional 20% Requirement of Interment Flags NSN 8345-00-656-1432 to the Procurement List

Dear Ms. Milkman:

Pursuant to the Notice of Proposed Addition to the Procurement List of an additional 20% of the government's requirement of interment flags, NSN 8345-00-656-1432 ("Interment Flags"), published in the Federal Register on Friday, May 24, 1996, the current contractor, Valley Forge Flag Company, Inc. ("Valley Forge") submits its comments.

Valley Forge has been a manufacturer and supplier of Interment Flags to the government for over 40 years. The Department of Veterans' Affairs ("VA") is the government agency charged with purchasing Interment Flags. Because of the unique nature of Interment Flags, these items must be manufactured in compliance with very strict federal specification requirements.

For reasons discussed hereafter, Valley Forge believes that Interment Flags are not an appropriate commodity for the procurement list. In addition, the proposed action of the Committee for Purchase from the Blind and Other Severely Handicapped ("Committee") will have disastrous consequences to Valley Forge.

I. SEVERE ADVERSE IMPACT

Section 51-2.4(e), Title 41, Code of Federal Regulations provides that the Committee, in determining whether to add a commodity to the current list is to consider whether "a proposed addition to the procurement list would have a severe adverse impact on the current or most recent contractor for the specific commodity or service."

The Committee's assessment of severe adverse impact deals almost exclusively with whether a proposed addition exceeds 20% of an incumbent contractor's total annual revenue.[1]

Valley Forge retained Siegel Management Company to perform an analysis and draw conclusions with respect to the likely adverse impact of the Committee's current proposal.[2] A copy of this analysis is attached as Enclosure C.[3] As an introduction to the report, a concise statement is presented concerning the methodology utilized.

Valley Forge believes that the Committee's simplistic approach is insupportable since it relies primarily, if not exclusively, upon an analysis of the percentage of total revenue taken from an affected company as a result of the Committee's action. Other factors that also should be considered include:[4]

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[1]Enclosure A is a document obtained from the Committee under the Freedom of Information Act which shows that in April of 1993 Eric Beale performed an adverse impact analysis on the effect on Valley Forge of an earlier Committee set-aside of interment flags. A review of Committee set-aside determinations since 1990 reveals that the Committee's decisions state that the Committee's normal procedure is to exclusively evaluate the percentage of sales that are set aside. If this amount does not exceed an unstated but determinable percentage of total revenue, the Committee always decides to set-aside the product or service.

[2]Enclosure B is the resume of Eric S. Siegel, the Principal of Siegel Management Company.

[3]Mr. Siegel's report is in the final stages of completion. It will be furnished to the Committee in the next day or two.

[4]Neither the Committee's regulations in the Code of Federal Regulations nor the Committee's handbook prescribe criteria to consider in making an adverse impact analysis.

1. Valley Forge's cash flow and the impact of an additional loss of 20% of Interment Flags on cash flow;

2. the profitability of Valley Forge. This should include a comparison of its asset and expense structure to determine what portion of the company's fixed and variable expenses would change with the loss in sales;

3. the overall financial strength of Valley Forge. This should encompass an evaluation of assets, liabilities, long and short-term debt, liquidity of assets and standard ratios reviewed by banks and lending institutions;

4. long-term debt and lease obligations;

5. an evaluation of the flag industry including government and commercial sales;

6. Valley Forge's investment in machinery and equipment to manufacture the Interment Flag. This equipment is not directly transferable or useable for other work;

7. an analysis of the value of Valley Forge to determine the reliance of Valley Forge on the Interment Flag contract which it has held for several decades;

8. an analysis of previous and proposed set-asides by the Committee for government flag procurements. This would include the impact of set-aside involving code signal flags, as well as pending set-asides of procurements for flags by the Department of Defense;

9. an analysis of the local marketplace in which Valley Forge operates. This would include the unemployment rate and the likely ability of laid-off workers to secure similar gainful employment;

10. a balancing of the good to be achieved versus the harm caused. Although there is no requirement for a balancing in either the statute or the Committee's regulations, common sense would dictate that such a balancing occur.[5]

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[5]Although neither the law (JWOD) nor the Committee's regulations require a balancing, the Executive Director of the Committee in a letter to Michael Liberman dated August 11, 1992 stated "It is then the Committee's responsibility to determine whether the benefits of adding an item or a portion thereof, to

As established by the analysis of Siegel Management Company, the Committee's announcement to take an additional 20% of the VA's requirement for Interment Flags would have a significant and severe adverse impact on Valley Forge. Only three years ago, the Committee took 20% of the VA's requirement for interment sales from Valley Forge. As Valley Forge stated at the time, it invested in new capital equipment in 1991 and also purchased and rehabilitated a new manufacturing facility in order to adequately and efficiently perform the manufacturing of the Interment Flags for a contract that Valley Forge has held for decades. The Berks County Industrial Authority's issuance of Industrial Revenue Bonds for use by Valley Forge was premised upon the Authority's assumption that Valley Forge would be able to compete for the entire Interment Flag requirement. This may no longer be true. Adding an additional 20% of Interment Flag sales to the procurement list, would reduce the total VA acquisition of Interment Flags by approximately $6 million. This would materially and significantly affect the minimum cash flow mandated by Valley Forge's lenders.

Valley Forge has suffered significant losses since the Committee's action in 1992. For example, in 1993, Valley Forge suffered a loss of $886,661.00. Valley Forge did not incur losses in 1994/1995 but only because during those years, for unexplained reasons, the VA purchased approximately 500,000 flags from Valley Forge (approximately 100% of its yearly requirement) and 150,000 flags through the workshops.[6]

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the Procurement List offset any potential adverse impact on the current or most recent contractor." (emphasis supplied) Enclosure D. Having committed to the above, the Executive Director reversed her position in a memorandum of July 30, 1993 during a request for reconsideration by Valley Forge of the Committee's initial set-aside determination. Enclosure E, p. 5.

[6]Although the Committee's actions in 1993 stated that only 20% of the VA's requirement was being set aside, a far greater percentage of flags was actually set aside. Contracts totalling 150,000 flags currently are in force between the VA and two workshops. In addition, the VA's purchase in 1995 of 650,000 flags will result in a significant number of flags in inventory which will likely further reduce the flags which will be available for competitive bidding.

A. Adverse Impact Of Previous Committee Actions

The Committee acknowledges that Navy code signal flags and military flags procured by the Department of Defense had been on the procurement list until recently. For some unexplained reason, the Committee only uses the prior three years to assess harm. We do not agree that three years is the appropriate time frame. In addition, during a meeting with the Executive Director of the Committee in February 1996, we provided data which established that the Committee's calculation that only $10,000 of signal flags had been set aside during the preceding three years was wrong. The Department of Defense procures a relatively uniform number of Code Signal Flags a year.[7] Data maintained by Valley Forge demonstrates that the number of signal flags that were procured from Valley Forge during the period of time between 1981 and 1996 totalled approximately $4,042,260.00, or an average of $252,641.00 per year (Enclosure F). Excluding the unusual years 1995 and 1996, 12 of the remaining 14 years showing Valley Forge's sales of Code Signal flags to DOD to be significantly below this average. The reason is because NIB workshops were manufacturing many and in some cases most of the flags.[8] The Committee's actions have adversely affected Valley Forge for more than 20 years. The failure of the Committee staff to calculate accurately the flags previously placed on the procurement list is unconscionable. The Committee's determination, which was based on inaccurate numbers minimized significant prior Committee actions.

B. Severe Adverse Impact On Valley Forge's Employees

The Committee's proposed action will have a severe negative effect on Valley Forge's employees. Not only will a significant number of employees be immediately unemployed, it is very likely that Valley Forge may cease to exist as a viable enterprise leaving its entire work force without means of support and little chance to obtain comparable employment in Berks County. Unfortunately, the Committee chose not to consider the harm to employees of Valley Forge, who were and will be economically harmed through no fault of their own.

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[7]The large number of flags in 1995 and 1996 represent pert-up demand because of the inability of NIB to perform.

[8]NIB never could produce all the Code Signal flags. The most complex patterns continued to be procured by DOD through the competitive market, and Valley Forge won most of these procurements.

II. THE COMMITTEE ABROGATED ITS RESPONSIBILITY TO MAKE THE ADVERSE IMPACT ANALYSIS

Documents obtained by Valley Forge under the Freedom of Information Act show that the National Institute for the Severely Handicapped ("NISH") actively participated and may well have made the determination whether the initial 20% set-aside in 1993 represented a severe adverse impact to Valley Forge. Enclosures G, H, I and J show that NISH actively worked on the determination of severe adverse impact. In fact, a fair reading of the documents leads to the conclusion that NISH made the determination which the Committee staff merely rubberstamped (Enclosure A). Such dereliction of responsibility is indefensible.

III. THE PROPOSED WORK CENTERS FAILED TO MEET REGULATORY MANDATES

Section 51-1.3, Title 41 Code of Federal Regulations, provides that a qualified non-profit agency in the provision of a procurement list commodity must employ severely handicapped or blind persons for "not less than 75% of the work hours of direct labor, required to furnish such commodities or services." In 1992/1993, Valley Forge estimated that in the prior 20% Interment Flag set-aside, the work centers would do less than 20% of the total direct work in producing the flag. One of Valley Forge's principal competitors, C. F. Flags, Inc., of Huntsville, Alabama, would be the principal subcontractor to the workshop in Huntsville. The Committee's response to Valley Forge's objections did not challenge Valley Forge's number but stated that the proposed work centers only needed to do 75% of the work retained by the workshops even if that meant the work centers would subcontract out most of the work to for-profit companies.

In addition, Enclosures K, L and M show that the work centers are in violation of even the Committee's ludicrous interpretation of the 75% requirement.[9]

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[9]Valley Forge also notes from documents received under the Freedom of Information Act that the work centers have submitted a number of waiver requests to specifications requirements. The work centers also have not met the delivery dates of the contracts. Thus, the work centers are not performing satisfactorily even on the 20% that already has been set aside, let alone likely being in a position to satisfactorily perform on an additional 20%. One of the three work centers that was originally designated to perform the Interment Flag contract is located in Florida. During performance on the first 20% that work center determined that it could not make the flags. Valley

IV. THE PROPOSED ADDITION WILL RESULT IN A TRANSFER OF JOBS FROM A FOR-PROFIT, NON-HANDICAPPED CORPORATION TO ANOTHER FOR-PROFIT, NON-HANDICAPPED CORPORATION

Valley Forge objects to the Committee's action which has enabled C F Flags of Huntsville, Alabama to become a viable competitor without the need to enter the competitive marketplace. Valley Forge objected to the initial set-aside when it learned that much of the work would be transferred from Valley Forge to C F Flags with relatively few jobs being filled by the ostensible prime contractor, Huntsville workshop. The true nature of the relationship is evident from Enclosure N, a fax from a Vice President of C F Flags, Inc. to the contracting officer at the Department of Veterans Affairs in which this "subcontractor" to the NISH South Region communicated directly with government officials requesting a deviation from the specification. No legitimate prime contractor would permit such direct communication to take place.

CONCLUSION

V. THE SET-ASIDE PROPOSAL WILL NEGATIVELY IMPACT VALLEY FORGE TO A SIGNIFICANT DEGREE

As the Department of Justice member Dr. Richard Seiter said during his vote on the last set-aside, such an addition "is too severe an impact". Further, he stated "the addition of this product is expected to provide work for only 8 blind/severely handicapped workers. Creation of so few jobs for blind/severely handicapped workers does not balance out the hardship that would be encountered by the current contractor." (Enclosure O).

The decision in 1993 to set-aside the first 20% of the interment flag procurement was based upon improper input from NISH which, because it receives a 4% fee on all set-asides, is in an inherent conflict of interest position to make determinations concerning adverse impact. The Committee which is charged with administering the program fairly, has not done so.

Valley Forge also has been unfairly maligned. Members of the Committee have repeated statements against Valley Forge to

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Forge was recently advised by representatives of NISH that the Florida work center now wants to again attempt to manufacture the interment flags. Given the proven lack of ability to manufacture the flags, it is not appropriate to set aside an additional 20% for this work center.

the effect its quality was poor and therefore the VA did not want to deal with it. To check their information, Dr. Seiter had his assistant Todd Baldau contact the VA and Mr. Baldau's statements are reflected on the last page in paragraph 5 of Dr. Seiter's submission. They state "Ms. Randa Gluba, Inventory Management Specialist with the DVA expressed satisfaction with Valley Forge Flag's price, quality and delivery performance."[10]

Finally, the proposed addition of an additional 20% of interment flag sales is wrong. Valley Forge will be severely economically impacted. The workshops will perform far less of the work than for-profit companies which should be competing against Valley Forge and not obtaining contracts "through the back door." Valley Forge which is located in an already economically deprived area will be forced to lay off a significant number of employees. These layoffs and the other economic damage to Valley Forge constitute severe adverse economic harm.

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[10]Enclosure P is a memorandum for record written by the VA's Contracting Officer, Creath Hendricks. This document was obtained by Valley Forge pursuant to the Freedom of Information Act. It describes events which occurred in 1992. Paragraph No. 2 reflects on Valley Forge's performance. The memo identifies the only shipment by Valley Forge that the VA rejected. The result of the rejection was that Valley Forge appealed the rejection to the Veterans Administration Board of Contract Appeals. During discovery, the VA agreed to have the lot retested by an expert from the Department of Defense ("DOD"). After this inspection, the lot was subsequently accepted by the VA after Valley Forge proved to the VA and DOD that the rejection was wrong. After the VA accepted that shipment, it reimbursed Valley Forge for 100% of its costs for the shipment as well as paying a portion of Valley Forge's legal fees. No government agency reimburses a contractor all its incurred costs PLUS legal fees unless the government recognizes its mistake. The VA did acknowledge that its rejection of the flag shipment was incorrect.

Valley Forge respectfully requests that the board members reject the Committee's proposal as being unwarranted and contrary to regulatory requirements.

Sincerely,

Robert G. Fryling

RGF:lmm/K.Fryling\VFF\Milkman2.Ltr
Enclosures

cc: Michael I. Liberman, President (w/enclosures)

Expert's Report
Impact of the Loss of Department of Veteran's Affairs Procurement on Valley Forge Flag Company, Inc.

Background

Siegel Management Company (SMC) was retained in June of 1996 by Valley Forge Flag Company, Inc. (VFF) to serve as an expert witness in the matter concerning the prospective loss of revenue due to a reduction in the sale of interment flags to the Department of Veteran's Affairs (VA). Specifically, SMC's objective in this assignment was to offer conclusions as to the nature and the degree of adverse impact that VFF would suffer as a consequence of the loss of VA business. During a two week period, SMC had the opportunity to gather and analyze data and prepare this report presenting conclusions which it has drawn from its analysis.

Methodology

All aspects of the expert witness engagement described herein were undertaken by Eric Siegel of SMC. Mr. Siegel visited the VFF production facility on June 14 and had the opportunity to interview Michael Liberman, CEO, Greg Harris, COO and David Rumbaugh, Controller. Also during this visit, Mr. Liberman provided a tour of the VFF production facility which is located in Womelsdorf, PA. The objective of the visit was to develop a familiarity with the dynamics of the overall business and the nature and ramifications of the company's VA contract.

Subsequent to these interviews, SMC had the opportunity to review VFF's historical financial statements and materials describing the history of the company and the nature of its product line. SMC also interviewed Larry Charney of Ernst & Young, VFF's independent auditor. The intent of this interview was to gain a better understanding as to what factors might cause Ernst & Young to issue a "going concern" opinion for VFF. This, in turn, would be the basis for developing conclusions as to whether or not Ernst & Young would issue such an opinion if VFF were to suffer the anticipated reduction of VA business.

SMC also requested that VFF prepare and submit detailed pro forma financial statements together with underlying assumptions. These projections ran through calendar year 1998 and reflected the impact of a reduction of 20% (100,000 units) of VA sales volume and 40% (200,000 units) of VA sales volume. SMC critically reviewed these projections and assumptions and subsequently discussed them with Mr. Liberman, Mr. Harris and Mr. Rumbaugh. SMC then asked VFF to revise the projections reflecting the impact of designated changes As noted below, these revised projections then became an important influence in the conclusions presented in this report.

It should be noted that SMC asked VFF to provide an initial set of projections based on the judgment that it would be nearly impossible for an arm's length party to develop meaningful projections independent of the involvement of VFF's senior executives. Clearly, VFF's executives have the most intimate understanding of the dynamics driving their business and thus are integral to the process of developing projections. Having

obtained their insights (i.e. through the first set of projections), SMC was then able to contribute its objectivity, insight and judgment via the above noted revisions.

Defining Severe Adverse Impact

The JWOD handbook defines severe adverse impact as "that level of impact which might weaken the business base of the contractor to the extent that the firm's viability could be in jeopardy." This is an extreme definition but one which was given important consideration in the context of this analysis. Specifically, the proposed reduction in VA business was specifically considered with respect to whether or not it would result in a reasonable possibility that VFF's viability would be threatened (i.e. the JWOD definition speaks to the extent that the firm's viability *could* be in jeopardy).

The heart of any analysis intended to determine the extent of severe adverse impact necessarily revolves around the preparation of detailed pro forma financial statements which are supported by logical and substantiated assumptions. This level of financial analysis is the only means of determining the bottom line impact on a company and the impact that the company will experience with respect to its future viability.

Pro forma financial analysis will also drive other factors which may be considered in the determination of impact including any adverse effect on factors which extend beyond the JWOD definition. It should be noted that any definition of "severe adverse impact" is, in large part, arbitrary. While the JWOD definition speaks to the fundamental viability of a business, less extreme, but equally valid definitions might consider other factors such as employment impact, decline in profitability, impact on financial stakeholders including lenders and shareholders, impact on the local economy, impact on subcontractors, etc.

Regardless of one's definition, any analysis of severe adverse impact begins with the difficult task of looking into the future in an effort to determine what the bottom line financial impact will be on a company. It should be noted that this exercise requires considerable relevant expertise, if it is to have any significance. Projecting financial performance with any degree of reliability requires a high degree of familiarity with the business being studied and sophistication with respect to issues related to business planning.

Analysis

A study of VFF's pro forma financial analysis assuming the loss of 100,000 and 200,000 units of interment flags suggests that the company's financial performance would be dramatically effected if the anticipated loss in VA business were to become a reality. Several factors are integral to fully appreciating the reasons why such a dramatic loss would be experienced. These factors may be summarized as follows.

- VFF has established an operating cost structure designed to satisfy previous and anticipated public sector demand. Most notably, the company acquired its new Womelsdorf facility in 1991. The nature of the company's operations results in a financial structure characterized by a high degree of fixed costs. This includes high, fixed manufacturing overhead and substantial debt service related to the financing of the Womelsdorf facility. While some companies have the capability of quickly ratcheting back their cost structures due to a high degree of variable costs, VFF is significantly limited in this regard.

- Over the course of many years, VFF has become dependent on public sector demand. When one examines sales trends over the last seven years, it is clear that VFF's marketing and sales capability outside of the public sector is characterized by little in the way of development. The company's commercial business has experienced a modest decline since 1989 ($10.9 million in 1989 as compared to $10 million projected for the current calendar year). The company has been able to build retail sales volume since 1989, but this volume will represent less than 3% of total company sales in the current calendar year (approximately $2.5 million).

  While the company indicates that it can gradually build its private sector sales in coming years, the slow nature of this growth does not significantly mitigate the damaging effects of a sudden and major withdrawal of VA business (pro forma financial analysis does consider moderate growth in private sector sale).

- The net result of the above factors is that gross profit lost as a consequence of a reduction in VA business drops largely to the bottom line.

In considering the impact on the firm's future viability, SMC also interviewed Ernst & Young in order to determine what they would consider in issuing a "going concern" opinion for VFF. Such an opinion is tantamount to indicating the company's future viability is in question. Mr. Charney of Ernst and Young indicated that factors driving such an opinion would include:

- Loss of a major customer or source of sales volume. As a broad rule of thumb he suggested a loss of 10% or more of total sales volume would represent enough of a loss to raise the going concern issue.

- An ongoing pattern of net losses or cash flow deficiencies.

- Violation of covenants with a lender such that a borrower were in actual or technical default of its lending agreements.

As indicated in the above and following analysis, loss of the anticipated VA sales volume would cause VFF to fail on all of the three above noted criteria. (It should be noted that in the short period available to complete this analysis, SMC did not have the opportunity to review VFF lending documents, However, the company indicated that the anticipated losses and/or the issuance of a going concern opinion would constitute a technical default in the company's lending relationships).

The anticipated financial impact of the withdrawal of VA business is detailed in the projections attached to this analysis. This impact may be summarized as follows:

- At a loss of 100,000 units, the company immediately shifts from a position of solid profitability (though certainly not extreme given the level of capital in the business) to a position where it is experiencing a modest loss. It should be noted that the magnitude of this loss is mitigated by the reduction in officers' compensation which was inserted into the projection at SMC's request. This degree of loss would not immediately imperil the viability of the company on the basis of operating cash flow. However, the company's viability would become threatened in this scenario if:

  1) The company did, in fact, fall into technical default causing one or more VFF lenders to call the company's loan.

2) Or if this pattern of loss would continue which, by any standards, would result in an unacceptable level of return for shareholders in the business.

- At a loss of 200,000 units, the company immediately shifts to a financial position where its viability would be severely threatened. Annual projected losses immediately exceed $1.2 million in this scenario (even assuming a substantial reduction in officers' compensation). This magnitude of loss would quickly erode the company's capital base and would probably cause the company's loans to become non-performing. The company would find its access to capital limited which in turn could accelerate a downward spiral.

One would expect VFF to eventually cease operations if, as projected, this magnitude of loss were to be experienced

Additional Considerations

While not a part of the JWOD definition, one may wish to consider additional outcomes which may reasonably be considered to constitute "severe adverse impact." Most notably:

- Even if VFF did not immediately experience a threat to its viability in the 100,000 unit loss scenario, the company's financial position would be substantially weakened. The company would probably have to cut back on capital investment and other expenditures which are central to continued viability and growth. The company would thereby become more vulnerable to competitive threats and other adverse changes in the market place. Even if withdrawal of 100,000 units did not serve as a "knockout blow", it would certainly set the stage for such an eventuality.

- This, in turn would negatively impact existing and future employment opportunities. The company would immediately and significantly cut back on its existing base of production workers. The creation of future employment opportunities would also be effected. One may reasonably assume that the worker who loses his or her job would consider this effect on employment to represent a "severe adverse impact."

- The company uses subcontractors to assist in the production requirements related to the VA. While SMC did not study the impact of the loss of VA business on these subcontractors, VFF indicated that one in particular would be hard hit. This, too, would certainly be considered "severe adverse impact" by the subcontractor and those who would lose their jobs with that subcontractor.

Conclusions

SMC has concluded that the loss of 200,000 units of VA volume would constitute "severe adverse impact", even by JWOD's extreme definition. The loss of 100,000 units may also result in "severe adverse impact" by JWOD's extreme definition, though conclusions in this regard are not as clear cut. As noted above, if one considers additional criteria which extend beyond the JWOD's definition, the matter is more clear cut, and one may conclude the VFF would experience "severe adverse impact" even at the loss of 100,000 units.

Statement of

Michael K. McGee

Division Manager

National Environmental Testing, Inc.

Cedar Falls Division

on behalf of

International Association of Environmental Testing Laboratories
and the
ACIL (formerly the American Council of Independent Laboratories)

before the US House of Representatives
Committee on Small Business

July 18, 1996

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Michael K. McGee, M.S., CIH
Division Manager

Thank you, Madam Chairman and Members of the committee, for this opportunity to testify. My name is Michael McGee, and for the last 12 years I have been the laboratory manager for a small commercial environmental laboratory located in Cedar Falls, Iowa, doing business in Iowa and surrounding states. I am here to testify on the significant negative impacts that unfair competition from university laboratories and other tax-exempt nonprofit laboratory operations are having on the commercial laboratory industry.

Most commercial laboratories are small businesses providing independent testing services for environmental compliance, public health, and product safety purposes. As a group, we have contributed significantly to improvements in environmental conditions which have occurred over the last 20 years. However, with tight budgets at both the federal and state levels, we are facing increasing competition from university and "nonprofit" laboratories which are looking for ways to acquire additional revenue beyond their traditional government funding sources. These tax-favored laboratories have sometimes turned to providing routine, repetitive, commercial laboratory services to raise revenue for their operations - at the expense of commercial operations such as mine. This comes at a time when the supply of laboratory resources exceeds the demand for testing services, when a large number of private laboratories have gone out of business and many more are struggling.

The University Hygienic Lab at the University of Iowa is a good example. They perform as much as $1.5 million per year of routine commercial testing that could be performed by private commercial labs. The same thing is happening in other states, such as Wisconsin. In fiscal year 1994-1995, the University of Wisconsin State Laboratory of Hygiene performed $7 million of commercial testing routinely performed by commercial labs - and is planning to expand their operations by building a new $16.8M laboratory. Neither Iowa or Wisconsin have accounting systems in place so they do not know what it costs them to perform individual tests - as a result they frequently underprice, and drive down prices in general, in the marketplace. For example, a 1994 Department of Natural Resources comparison of the Wisconsin State

Laboratory of Hygiene prices with those of three private environmental laboratories found that the State Laboratory was undercutting the private labs on price for 89 out of 125 tests.

In Iowa, the same laboratory group we compete with in the marketplace is also responsible for auditing our laboratory under two - and soon to be three - separate laboratory certification programs required to perform environmental laboratory analyses in the state. Certification hinges on their recommendations and approval. They are not subject to audits by other State of Iowa personnel to ensure compliance with state certification requirements. This is a clear conflict of interest.

The Universities are not taking business away from private labs because they are necessarily better, faster, provide a higher level of quality, or are more responsive to customer needs than private laboratories. Instead, they are able to support their commercial operations through: 1.) the transfer of federal funds received under grants and contracts, subsequently used to fund commercial operations; 2.) avoidance of real estate, sales, and state and federal income taxes; and 3.) marketing the "halo effect" whereby their organization is presented as having no profit motive which presumably "corrupts" the quality of services provided by commercial laboratory operations.

What can be done to level the playing field for commercial laboratories in the commercial laboratory services market with regard to tax favored, nonprofit competition? There are four main areas in which I would recommend action:

1.) Develop strong policies limiting the use of all federal contracts and grants from use in supporting commercial operations of nonprofit groups. For example, a university should not be able to use a testing instrument purchased under a federal grant to compete with private commercial laboratories. The instrument should be limited for the purpose of the grant and other research activities.

2.) Universities and other nonprofit organizations should be required to pay income and sales taxes on profits realized through the performance of commercial work. In Iowa, my laboratory must charge a 6% sales tax to customers while the University of Iowa does not.

3.) A national laboratory certification program would help to remove the conflict of interest that exists in some states in which the state laboratory is involved in certification decisions on private laboratories, while at the same time competing with those same laboratories in the marketplace. In that way, university laboratories would be subject to the same requirements as private laboratories. A national laboratory certification program would also reduce the possibility of a public laboratory engaged in commercial activity from limiting the amount of private competition by using certification powers.

4.)Finally, it is important to construct legislation and policy that can be readily enforced through the courts, if need be. In Iowa, NET spent 8 years and approximately $100,000 attempting to enforce provisions of the "Iowa Noncompetition By Government Act" in the Iowa courts. We lost, because the act was poorly constructed, concerned mostly with creating and preserving exemptions for the University of Iowa rather than with protecting businesses such as mine from unfair competition.

Thank you for the opportunity to testify. I would be happy to answer any questions you may have for me.

NFIB
National Federation of Independent Business

TESTIMONY OF

GENE MEIER

Owner, Lewistown Propane and Fertilizer

Lewistown, Montana

Subject: Nonprofit Competition

Before: Small Business Committee

U.S. House of Representatives

Date: July 18, 1996

600 Maryland Ave. SW, Suite 700 • Washington, DC 20024 • 202-554-9000 • Fax 202-554-0496

The Guardian of Small Business for Fifty Years

Hello, Madam Chair, Members of The Committee, I would like to thank you for the opportunity to speak to you today. My name is Gene Meier. I own and operate Lewistown Propane and Fertilizer in Lewistown, Montana. I have twelve employees and have been in business twenty-two years. During that entire time, I have been a member of the National Federation of Independent Business (NFIB).

NFIB is the nation's largest small business advocacy organization, representing more than 600,000 small and independent business owners across the United States. For more than half a century, NFIB has served the needs of small business on a broad spectrum of issues. NFIB sets positions on matters of public policy by a regular polling of the membership.

It is fitting that I have been asked to address this committee today regarding the matter of non-profit competition. The biggest threat to my professional career is the unfair competition of rural cooperatives. These co-ops are tax-exempt, quasi-government entities. They pay no State or Federal Income tax because they are advertised as "Customer Owned" or "Where the Customer is the Company." While they do pay some county taxes they are only a fraction of what my company pays. A so-called "benefit" they advertise is that they are a "non-profit" company. Why should a non-profit business be allowed to compete with real profit oriented tax paying enterprises? I know I can't continue to compete on this unequal playing field.

In the county where I live, there are eight farmers' co-ops competing against me. In that same area there are only two independent businessmen. Twenty years ago these numbers were reversed. The trend is for more non-profits to come into being -- not more businesses! With no taxes they can sell at lower prices until they are well established and I will be out of business! Twenty-two years ago when my father brought me into the business, the local Cenex Cooperative decided to take their market share in the propane business. This was followed by five years of below cost propane. It was not good for anyone. We barely survived. We paid very few taxes because we made little money. As soon as they gained a share, their prices rose to meet ours. My question again is how can a non-profit company be allowed to compete?

We are a Capitalist society, Co-ops are Socialist. This must change if any tax paying independent businesses are to remain. Cooperatives are in every part of our economy; agriculture, communications, transportation, insurance, computers, groceries, convenience stores, and the list goes on and on. The only thing you have to do to become a patron of a cooperative is to purchase just one item. In gasoline stations many times people only do one or two purchases and never return. I am sure they never receive a patron dividend.

Farmer-owned cooperatives seem to be sacred. Many have told me this could cost me my business because I am speaking out against the farming industry. Actually, the opposite has happened. I have had many people come

into my business and express their support. They also feel if you are in business you should pay taxes equal to everyone else in the community.

One major recommendation of the White House Conference on Small Business was to get non-profit, non-taxed business out of competition with legitimate business. This is also a high priority for the National Federation of Independent Business. I am sure everyone is aware of the impact independent businesses have on our nation's economy. If our government chooses to follow the agenda of the National Federation of Independent Business, we will all benefit.

In closing, I don't want to destroy any businesses, just make it equal across the board for all businesses. I would like Congress to level the playing field. Make every business a profit-oriented, tax paying business. If they can't compete by paying on the same tax base and running with a profit, they shouldn't be in business.

I appreciate your taking time to hear my concerns and I would be pleased to take any questions you might have.

Testimony of Lou O'Brien
Model-Star Services
on behalf of
Textile Rental Services Association of America
and
Business Coalition for Fair Competition
before
The House Small Business Committee
July 18, 1996

Good morning, my name is Lou O'Brien, I am Chairman of Model-Star Services, which has been located in Danville, Illinois for over 100 years. The company was started by my grandfather in 1894 and is still a family-owned business today. Model-Star is a textile rental company involved primarily in providing laundry services to the healthcare industry.

I am appearing today on behalf of Model-Star and the Textile Rental Services Association of America (TRSA), a non-profit trade association representing 1,700 member companies. Members are for-profit companies engaged in textile maintenance and rental services to commercial, industrial, and institutional accounts. Major customers of textile rental companies include hotels, restaurants, hospitals, nursing homes, doctors' and dentists' offices, medical and dental clinics, schools, and manufacturing facilities. The combined textile rental industry had sales of $6.7 billion in 1994, while employing more than 110,000 people nationwide.

Before I begin my testimony, I would first like to commend the committee and the Chairwoman on holding these important hearings. It is critical to our industry that Congress be made aware of how nonprofits are eroding business opportunities for the textile rental industry and other industries, as well. Increasingly, tax-exempt nonprofits are soliciting laundry service from TRSA's tax paying member companies.

The first part of my testimony will focus on how nonprofit hospitals unfairly compete with companies like mine and the second part will focus on government procurement set-asides that continue to erode business opportunities for the textile rental industry.

I. Nonprofit Hospitals

Model-Star has continuously been faced with competition from nonprofit tax-exempt organizations in the healthcare market. Although the IRS requires that nonprofit hospitals be subject to taxation on unrelated business income or on income producing activities -- hospital accounting systems mask any substantial profit. Most of these laundries claim that for tax purposes they operate on a "break even basis" and therefore do not pay a tax.

At the same time, there is a major effort by nonprofit hospitals to take advantage of their tax-exempt status to obtain an unfair competitive advantage over TRSA member companies that must pay a tax on earnings and generate capital from commercial sources. Many nonprofit hospitals have in-house laundries or own a cooperative laundry in combination with other nonprofit hospitals. Most of these laundries were built with federal funds and were designed with excess capacity to account for projected increases in need. However, a declining population and shorter hospital stays have left many hospitals with 40 to 60% of laundry capacity unused. This amounts to decreasing revenue and to remedy the financial crisis, many nonprofit hospitals have decided to use their excess capacity to generate revenue.

Non-profit hospitals are using aggressive sales and marketing tactics to solicit business, including other hospitals and nursing homes, but also restaurants, healthclubs and a full range of "linen supply" customers normally served by TRSA members. As a trade association, TRSA has advised the Health Care Financing Administration (HCFA) and the Internal Revenue Service on the possible misuse of tax exemptions that compete with for-profit companies. However, the invasion into the commercial marketplace continues.

Textile rental companies face competition with nonprofit hospitals offering prices that bear no relationship to cost. These prices are quoted to obtain additional laundry business volume and in some cases the prices are 50% below market prices. Not only do nonprofit hospitals have extremely low overhead because of their tax exempt status, but in pricing their services they fail to use generally accepted accounting principles to determine their costs and thus fail to take into account their real overhead expenses. Even if they price their services at a slight margin over their direct costs on the assumption that this will result in small cash surplus, in reality they are below actual costs because they do not reflect indirect costs.

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Hospitals were granted tax exempt status in the early part of this century in return for providing charitable healthcare and run their operations on a nonprofit basis. Today, there is little resemblance to that scenario.

Today, over 90% of the hospitals' services are charged at a profit to insurance companies, Medicare/Medicaid, and private taxpayers. Nonprofit hospitals make money - and some of them make a lot of money. However, most of it doesn't show because they have distributed their excess cash to foundations and other investment companies that run their for-profit activities. The annual reports of the hospitals in most cases do not reflect the wealth contained in their foundations and other holdings.

The hospitals pay no income taxes on their earnings or property taxes. Supposedly, they pay tax on the profits of their unrelated business activities - but they control the profits by adjusting the charges between them, and a good part of the for-profit activities run at a loss.

Recommendations

The granting of tax exempt status was intended to be in exchange for providing charitable services which the government would otherwise have to provide. It was not intended for the nonprofits to use these privileges to expand their commercial activities.

- Prohibit nonprofit hospitals from entering into the commercial laundry and linen rental business. Nonprofit hospitals should be prohibited from serving non-healthcare customers from their on-premise laundries or shared service laundries. Further, they should not serve other healthcare customers from their own or shared facilities where there are adequate commercial services available.

- Prohibit tax-exempt hospitals from providing laundry services to any entity other than their specific tax-exempt hospital.

- Use generally accepting accounting principles.

- Require not-for-profit laundry hospital groups to pay their fair share of property and local taxes (i.e., state, county, local property, and other taxes).

II. Procurement Set-Asides

I would now like to focus the committee's attention on another government sanctioned program which also threatens many small businesses in the textile rental industry. The Javitz-Wagner-O'Day Act (JWOD) establishes procurement set-asides for the blind and disabled. These nonprofit organizations are tax-advantaged with the added advantage of having a procurement preference second only to Federal Prison Industries. Under the law, if the Committee for the Purchase from People Who Are Blind and Disabled adds a facility to the Procurement List, agencies have no choice but to contract with these nonprofit organizations.

While we support the goal of providing employment and training opportunities for the blind and disabled, at the same time, we believe that something needs to be done to stop the continued erosion of laundry business. The set-aside has begun to threaten the viability of many small businesses in the textile rental industry. We do not believe that Congress intended for these nonprofits to unfairly compete with the private sector.

In recent months, it has become clear that these nonprofits have decided to go into the laundry business. My own experience tells me that once these groups decide to do something, it does not matter whether they have the capabilities or expertise to provide laundry services. TRSA can attest to the fact that once laundry services were added to the Procurement List, nonprofits have made an all out push throughout the country to get government business-- from Veterans' Affairs (VA) Medical Centers, to providing laundry services to military bases. Textile rental companies have just begun to lose laundry accounts and there is no reason to expect that the trend will end or even slow down--unless Congress stops it.

Our experience with the Human Resources Center in Paris, Illinois is the beginning of a nation-wide trend. Nonprofits, like the Human Resources Center, often provide laundry services at higher costs to the government. As a mandatory source, they do

not have to compete for government business. Specifically, we question whether some nonprofit agencies are capable of providing laundry services at a fair market price. In my case, the Danville VA Medical Center in Danville, Illinois was forced to contract out its commercial laundry work to the Human Resources Center, a nonprofit entity for the disabled. The VA contracted out laundry business to the Human Resources Center despite the fact that it did not have the capacity or expertise necessary to handle soiled healthcare linen. OSHA's bloodborne pathogen standards must be followed in healthcare linen service to ensure that healthcare workers' and patients are protected from the spread of bloodborne diseases. And the price was *higher* than the price per pound quoted by Model-Star.

In the most egregious example, a nonprofit agency bid on a contract only at the suggestion of a government contracting officer: a practice which is inherently counter to fundamental principles of government interference in the marketplace.

TRSA believes that the system needs to be fixed! While TRSA supports the goals of the JWOD to increase employment and training activities for the blind and disabled, our members continue to lose substantial business to these nonprofit agencies.

TRSA is concerned that the Committee is not giving proper consideration to the criteria set forth in the regulations when determining the suitability of adding a commodity or service to the Procurement List. The Committee's decision must take into consideration whether the nonprofit is capable of performing the work, whether the commodity or service will be provided at a fair market price, and the impact on the current or most recent contractor for the commodity or service. We would also like to underscore that textile rental companies often provide laundry services below the *fair* market price established by the Committee.

The Committee is also given the authority to make a determination that an addition to the list would have a severe impact on a particular company and decide not to include the commodity or service on the Procurement List. However, in many cases the current contractor is not notified by the Committee of the proposed addition and is not given any opportunity to submit data showing the projected loss in revenue. The Committee does not consider the impact on companies unless the contract constitutes 15% or more of total revenue or evaluate the implications to the local economy--which may ultimately mean that jobs are lost.

Recommendations

- Congress should revise the law to ensure that the Committee evaluates the impact to the current contractor.

- Direct the Committee to consider the cumulative effect on textile rental companies that have lost a number of contracts to nonprofit entities.

- Direct the Committee to evaluate the impact of the proposed set-aside on the local economy.

III. Conclusion

It is time for Congress to put an end to unfair competition from nonprofit entities. With a continually eroding tax base, Congress needs to assess the value of these tax breaks and set-asides for nonprofits. Are nonprofits providing a necessary service or are they making money at the expense of taxpayers?

Congress also needs to evaluate set-asides for the blind and disabled in view of the goals of the Americans with Disabilities Act. Further, the committee needs to evaluate the legislative intent of the 1938 Javitz-Wagner O'Day Act. The law was not intended to promote opportunities for the blind and disabled at the expense of the private for-profit sector. We ask that Congress level the playing field!

This concludes my testimony this morning. I appreciate the opportunity to appear before the committee.

Testimony

of

Roger S. Ralph

President

Bel Air Athletic Club

Harford County, Maryland

and

Chairman

Fair Competition Committee

of the

International Health, Racquet and Sportsclub Association

Before the

Committee on Small Business

U.S. House of Representatives

Regarding Unfair Competition

by Nonprofit Organizations

and the Government

July 18, 1996

Thank you, Madame Chair. I am Roger Ralph, President of the Bel Air Athletic Club in Harford County, Maryland. I am a former member of the Board of Directors of IHRSA, the International Health, Racquet and Sportsclub Association, and am also the current chairman of IHRSA's Fair Competition Committee. I am also chairman of the Maryland Legislative Committee for the Mid-Atlantic Club Management Association. I'm speaking to you today both as a health club owner who faced potential unfair competition from tax-exempt health clubs and as a representative of IHRSA.

First, Madame Chair, I would like to share with you some information about IHRSA and the commercial health club industry. IHRSA is a not-for-profit trade association made up of owners, suppliers, and developers in the health, racquet and sports club industry. IHRSA represents more than 3,000 clubs serving over 3.6 million consumers and more than 400 manufacturers. Formed in 1981, IHRSA (formerly known as *IRSA, the Association of Quality Clubs*) helped set the pace for the expansion and evolution of the health and fitness club industry during the 1980s. IHRSA had grown ten-fold during that time, from a homogeneous group of tennis and racquetball clubs, to a diverse array of clubs serving the varied needs of America's health-conscious consumers.

IHRSA members maintain high standards for the fitness club industry and are committed to ensuring that consumers receive the full benefit of their investment in the active, healthy lifestyles that club membership provides. IHRSA has adopted model consumer protection legislation and works for its passage by state legislatures. To that

end, all member clubs must sign IHRSA's Membership Pledge (Attachment A), adhere to its Code of Conduct (Attachment B) and meet the Association's eligibility criteria.

Allow me to provide some general statistics on the fitness market for the Committee's background information. The total annual volume of our industry is $7.3 billion. We estimate there are presently 48,000 fitness facilities in the country with 20 million memberships. Among them are 12,000 for-profit health and sports clubs and 15,000 tax-exempt and government facilities. The remainder are located in hotels, apartments, and country clubs, etc.

My wife Elaine and I started the Bel Air Athletic Club in 1980, thanks to an SBA-guaranteed loan. We began with one acre of land, ten racquetball courts, a handful of employees, and the nervousness and anxiety of small business owners worried about meeting payroll, tax, and debt service obligations at a time when interest rates exceeded 18 percent. By 1996, our business has expanded to a 90,000 sq. ft. community- and family-oriented athletic club on eight acres that employs 250 personnel.

We provide 67 children's sports classes a week, dance training to 300 children and adults, several thousand swim lessons annually, a masters and youth swim team, a summer camp for 600 children, new energy programs for our 1500 members who are over the age of 50, tai chi and yoga classes, and aerobic, strength training, nutrition and weight loss programs, as well as programs for persons suffering from arthritis. Additionally, we are the landlord for Union Memorial Hospital's Sports Medicine Center and the Mid-Atlantic Cardiology Associates.

We are including with our testimony today the *1996 Bel Air Athletic Club Summer Program Guide* to give you a better idea of the scope of this particular community- and family-oriented health club.

I can tell you from personal experience that if we had not successfully educated the public and elected officials about the realities of unfair competition from the nonprofit and government sectors, our own club would never have grown beyond a 25,000 sq. ft. racquetball facility with 15 employees. In fact, this unfair competition might have driven us out of business.

Instead, we have contributed millions in income and property taxes to local, state, and federal governments, have become one of the largest employers in our county, and have served as the major contributor to our local Boys and Girls Clubs and the Harford County Maryland Sexual Assault/Spousal Abuse Center. We truly want to serve as a model for our industry and the nation.

I firmly believe in the engine of entrepreneurship and the expansion of small business opportunities. And, I for one, am happy to pay taxes if (1) my business is successful; (2) the government is not wasting my tax dollars; and (3) public policy does not promote or facilitate unfair competition in instances where the market place can provide the service or product that the public demands.

Beyond that I firmly believe that all businesses have a social responsibility to improve the quality of life in their communities. I personally believe business entities

should voluntarily try to give five percent or more of pretax profits to community and charitable programs.

With this said, however, I am tremendously disturbed that, in general, politicians, government officials, and many, many nonprofit personnel and volunteers are either uninformed or naive or completely disregard unfair competition issues.

UNFAIR COMPETITION FROM TAX-EXEMPT ORGANIZATIONS

Unfair competition is an ignored public policy issue that hurts everyone. It hurts the development of growth industries, like the fitness industry. It hurts small businesses, the sector recognized as "the engine that drives the economy," by forcing them to compete at a significant disadvantage to their tax-exempt competitors. It hurts communities that must resolve increasingly-complex social issues with a shrinking tax base. Long term it has the potential to unjustly and unfairly harm the thousands and thousands of worthy U.S. charities that truly provide services that cannot be provided via the market place and that truly serve needy individuals and families. It has the potential to harm the wonderful American tradition of generous giving because the "tainted" activities of specific nonprofits can have a negative impact on all nonprofit organizations. This is certainly not in the public interest.

But most of all, unfair competition hurts every single taxpayer. The *Philadelphia Inquirer* reported that tax-exempt organizations' "exemptions are costing more than $36.5 billion a year in lost revenue... That is the equivalent of the income taxes paid by the

twenty-five million taxpayers whose income is between $12,000 and $25,000." Excluding churches, nonprofit organizations generate $1.1 trillion in revenues annually. Yet, only $373 million was paid in unrelated business taxes in the year 1994. *There is something wrong with this picture.*

What is unfair competition? Let me use a definition from *Forbes* magazine, which defines unfair competition as "... a significant confrontation with private for-profit businesses on terms that are not only unfair but also probably economically destructive" (November 26, 1990, page 100).

IHRSA defines "unfair competition" within the health and fitness industry as

> *... any situation where the government or non-profit sector competes directly with an existing or potential tax paying business by (1) serving a significant portion of a market that can be served by a tax paying health and fitness club; (2) pricing its products and services at below market rates; (3) obtaining land and/or facilities & equipment via public funds or tax deductible donations; and (4) not paying taxes.*

The following list of advantages enjoyed by a typical tax-exempt health club begins to explain the destructive nature of the competition. Tax-paying health clubs are forced to compete with a nonprofit facility that:

- is exempt from federal income taxes
- is exempt from state income taxes

- is exempt from local taxes
- is often exempt from sales taxes
- is exempt from property taxes
- does not pay for money (no interest)
- does not pay for land or buildings (no mortgage)
- receives large discounts on postal rates

Let me be more specific. In the case of the health club industry, unfair competition is very easy to identify and define. Eighty-five percent of a club's membership usually is found within a twelve-minute drive time of the facility. When a YMCA, a tax-exempt hospital, or a government agency offers services to the same market that can be served by a commercial tax-paying business, the tax-paying enterprise will lose significant market share, will lose money, will have difficulty obtaining financing for expansion, and will pay less taxes. A government agency or nonprofit organization does not have comparable debt service, does not pay real estate taxes, does not pay income taxes, and obtains a 33 percent reduction in postal rates.

Unfair competition poses another dilemma for tax-paying clubs — membership fees. Unlike a commercial health club, a nonprofit or government-run club can price its product below market value, if it so chooses. On a $3,000,000 health club project, for example, the government or a nonprofit will enjoy an annual operating cost advantage of half a million dollars. As Table A illustrates, a tax-paying health club with

TABLE A: FINANCIAL IMPLICATIONS OF UNFAIR COMPETITION IN THE HEALTH CARE INDUSTRY

	Annual Cost to Gov't or Non-Profit Sector	Annual Cost to Tax-Paying Sector
Land Carrying Costs *Land valued at $100,000 per acre; 15 yr. loan on $500,000 at 9% interest	0	$ 60,856
Building Mortgage *$2,000,000 borrowed at 9% interest/15 yrs.	0 *government bond*	$243,424
Furnishings & Equipment *$300,000 borrowed at 11% interest/5 yrs.	0	$ 78,273
Postage Non-profit sector receives 33% discount and free distribution via schools and gov't agencies	$13,320	$ 20,000
Property Taxes *42% tax rate of $3.00 per $100	0	$ 37,800
State Income Taxes *State tax rate of 7% on a profit of $200,000	0	$ 14,000
Federal Income Taxes *Federal tax rate of 22.5% on first $100,000 and 39% on next $100,000	0	$ 61,250
Total Annual Comparative Operating Costs	$13,320	$515,603

*Assumptions based on a $3,000,000 health club project on five acres SOURCE: Harford County Coalition for Fair Competition

1500 members has to charge nearly $30.00 a month per membership simply to cover costs that nonprofits and government agencies don't even have to consider.

Unfair competition slows the development of our innovative growth industry while undermining this country's tax base. From the standpoint of sensible public policy, the tax-paying quality health club industry should be encouraged — not discouraged — to expand. As chairman of IHRSA's Fair Competition Committee and a club owner, I have seen first hand the devastating economic impact of unfair competition. Fighting unfair competition takes me and all other club owners away from running our businesses, which is why I prefer cooperation to confrontation on the issue of unfair competition.

Cooperation, however desirable though, is not always possible. Many tax-exempt health clubs view their fitness facilities as money makers that fuel their entire organization. Health and fitness have become big business in the United States, Madame Chair. Nonprofit organizations are building many facilities aimed at the commercial health club market for a very simple reason — to generate profit or surplus. The problem with this strategy as it relates to the health and fitness industry is that it inhibits the development of a tax-paying growth industry and it encourages nonprofits and government agencies to engage in activities that can be provided via the market place. Further, it allows nonprofits to justify any of its commercial activities and fosters a policy on the part of some nonprofit organizations to ignore fair competition principles.

Tax-paying and tax-exempt health clubs compete everywhere. The most recent government study found that 87 percent of tax-paying fitness clubs in the United States

compete with tax-exempt health clubs. In many markets a commercial health club may compete with a YMCA, Jewish Community Center, a college or university fitness center, a tax-exempt hospital club or even the local Park and Recreation Department.

YMCA CLUBS

Take the YMCA, for example. In 1994, the YMCA, through aggressive expansion of its fitness centers, collected a staggering $1.9 billion in gross revenue — a 9.7 percent increase in just one year. As a result, the YMCA rose to the top of the list as the single biggest "charity" in the United States. Between 1990 and 1992, the YMCA expanded its membership dues — paid primarily for fitness facilities — by over 22 percent according to *Forbes* magazine. For the same period, a survey of IHRSA's leading clubs indicated average dues growth of 7.5 percent — approximately one-third as much as the YMCA.

Some YMCA officials justify direct competition with tax-paying health clubs by saying their mission is to "serve the entire community." They also justify building YMCAs in middle- and upper-income areas by saying they use funds generated in these places to subsidize Ys in inner cities and low-income suburban areas.

But is this really the case? I believe a thorough objective investigation would find otherwise.

As I said, the YMCA, with $1.9 billion in annual revenues, is the nation's biggest charity. Yet only 12 percent of its revenues come from donations. Reportedly, only 10 percent of its membership nationally is on scholarship or receives financial assistance.

Contrast this with the Boys and Girls Clubs of America. Eighty-three percent of the revenue of Boys and Girls clubs comes from grants and donations, their average membership dues is less than $5.00 per month and 53 percent of the children they serve come from single-parent families. To the best of my knowledge, the private sector has never complained that the strategies and activities of, for example, the Boys and Girls Club of America or the Police Athletic League or Big Brothers/Big Sisters are inconsistent with their stated mission or that their mission was not appropriate to today's social realities. That is totally different from our industry's view of some YMCAs who adopt a conscious strategy and devote major resources to constructing and operating YMCAs in middle- and upper-middle income areas.

OTHER SOURCES OF UNFAIR COMPETITION

It is not just the YMCAs that frequently use their tax-exempt status as a shield to compete unfairly with tax-paying health clubs. Nonprofit hospitals are now beginning to operate tax-exempt commercial health clubs. They do not pay taxes. They use tax-exempt donations and hospital funds to construct and operate these so-called "nonprofit" facilities.

In fact, many health club operators believe that hospital-owned, tax-exempt health clubs pose one of the greatest sources of future unfair competition. The *Philadelphia Inquirer* reported that

> *Nonprofit hospitals, which originally were exempted from taxes because of their charity care, now devote an average of six percent of expenditures to caring for the poor. Meanwhile, more than $1 billion in hospital profits have been shifted into commercial spin-offs — hotels, restaurants, health spas, laundries, marinas, parking garages .... in the 1980s, nonprofit hospitals invested more than $500 million in such centers as they sought to develop new revenue sources.*

The specific case of the Sioux Valley South Dakota Hospital (Association v. South Dakota State Board of Equalization), unfortunately, is probably the rule rather than the exception of what happens when a nonprofit hospital enters the health club business. The Hospital started a tax-exempt commercial health club but they claimed it was different from the commercial health clubs because it was more "health" oriented and provided community service by opening the center to everyone regardless of their ability to pay. Although this may sound good, an examination of the Hospital's health club membership revealed that of the center's 2669 memberships, only 14 — less than one-half of one percent — were free or got reduced fees.

Hospital health clubs and other nonprofits justify their tax-exempt status by arguing that they promote health. Yet both state courts and the U.S. Internal Revenue Service (IRS) have rejected the notion that providing fitness services to healthy people

constitutes promoting health. The IRS Exempt Organizations CPE Technical Program Textbook states:

> *The Service position is that the health club promotes health, but only in a manner that is collateral to the providing of recreational facilities, even where a community-wide benefit is conferred. While innumerable recreational activities may constitute a form of promotion of health in that exercise generally may assist in the prevention of illness and be consistent with generally recognized medical principles and conducive or beneficial to the soundness of the body and mind, it cannot be said that all such activities can be recognized as promoting health under IRC 501(c)(3).*

The uneven playing field and the destruction unfair competition causes tax-paying clubs are apparent not only in the numbers but in the realities of people's business lives.

Let me give you two examples from the National Capital area. First, imagine you owned a health club in the Reston, Virginia area. You purchased an expensive piece of property or you lease land and a building. You pay federal and local taxes. You pay full postal rates for all of your mailings. You and your spouse will lose your home and assets to the bank if you fail to meet your loan obligations. And, then you read in the *Reston Times* that the YMCA of Metropolitan Washington has just received a $1.00-a-year lease for fifty years on eight acres of land in one of the wealthiest communities in America —

Reston, Virginia — to operate a health club and teen center that compete directly with your club and 20 other health clubs serving the same market.

To add insult to injury the entire process was done behind closed doors. Furthermore, the Fairfax County Supervisor, Robert Dix, who drove this arrangement under the guise of "I am simply doing good," is a member of the YMCA Board! Not a single health club owner was asked to provide a proposal to meet the county's objectives (perhaps Fairfax County didn't need more taxes or believed a single health club operator or business entity could not provide the desired service).

Let me give you a second example from my personal experience. Several weeks ago, three staffers from The Maryland-National Capital Park and Planning Commission visited me at the Bel Air Athletic Club. They wanted ideas for building a health club on public land as part of the new multi-million dollar sports complex associated with Jack Kent Cooke's planned new home for the Washington Redskins. This complex hopes to incorporate a world class indoor track and swim center. Neither of these features is likely to be commercially-supportable via market forces; however, their proposed health club certainly is.

Until meeting with me they had not even considered alternative approaches to insure that the delivery of health club services would enhance the area's tax base and not represent unfair competition for local health club operators. It is not that these planners were stupid. I found, in fact, that these planners were very bright and were amenable to collaborating with the private sector. It is simply that those responsible for public policy

decisions have not thought "outside the box" or established guidelines that require them to analyze alternative approaches that can expand the tax base, make the best use of scarce public resources, and promote fair, competitive business practices.

Let me give you a few more examples:

- In 1994, a tax-exempt hospital in Illinois opened an $8.3 million tax-exempt health and wellness club. Several miles away, Bannockburn Health and Tennis Club lost nearly 200 members to the new facility, representing a loss of about $250,000. In August 1995, this family-owned club went bankrupt and closed its doors because he couldn't make his bank payments.
- After negotiating with Pit County Memorial Hospital for five years on a wellness center joint venture, Ric Zimmerman, Chief Operating Officer of Athletic Clubs, Inc., in Greenville, North Carolina, found vacant land on the hospital side of town that was perfectly suited for a health club. The hospital declined to go forward with the wellness center, so Mr. Zimmerman built his facility. The week after Mr. Zimmerman started to pre-sell memberships for his tax-paying club, the hospital announced plans to build a $7.2 million tax-exempt wellness center 100 yards from Mr. Zimmerman's club.
- Tim Richards, owner since 1984 of Orchard Hills Athletic Club in Lancaster, Massachusetts, fears for the future of his business. A few years ago, a local community college opened its fitness facility to the public. Now, another area

community college, wanting to cash in on Richards' business, plans to build a $12 million public facility.

- The Galindo family, owners of AeroFit Health and Fitness Center in Bryan, Texas, doesn't have to speculate on the impact that a university fitness facility will have in their market. In April 1995, AeroFit had a membership base of 3,887, which had grown five percent over the previous year. In August 1995, when Texas A&M University opened its new recreation center to the public, AeroFit experienced a 10 percent decrease in membership within the first month alone. By April 1996, nine months after the Texas A&M facility opened, AeroFit's membership base had dropped to 2,783 — a devastating 28.3 percent decrease from a year earlier.
- Competition by local government park and recreation facilities has a devastating impact on tax-paying clubs. A city-owned facility in Tucson, Arizona, forced Jim Halkemeyer to place his club in bankruptcy. Membership in Tom Dwyer's club, located within a thousand yards of the Tucson city facility, fell 30 percent in the first year after the city facility opened.

Tax-exempt health clubs defend their expansion into the commercial fitness market by saying they don't compete with commercial health clubs. But, neither common sense nor the facts support their contention. Common sense tells me that if a tax-exempt health club offers the same services, programs and equipment to the same market as a commercial health club, it is a tax-exempt commercial health club in direct

competition with tax-paying clubs. Let me share with you a few more facts that demonstrate how tax-exempt health clubs compete with for-profit clubs.

- Club operator Mark Welsh of Elkton, Maryland, learned of the Y's plans to build a new facility. When questioned, Y officials said they weren't building a facility that would compete with his club. Yet when Mark talked to a realtor about buying the old YMCA building, the realtor wrote back saying, "Please be advised that [my client] the YMCA is not interested in selling their facility to another competing health club operation from either in or outside of our area."
- IHRSA members Ted Torcivia, Ray O'Connor, and John Gebhart are working to stop Waukesha Memorial Hospital in Waukesha, Wisconsin, from building an $11 million tax-exempt health club that will compete with their facilities. Wouldn't you feel compelled to fight such a project when the Hospital's president, Ford Titus, tells the *Milwaukee Journal Sentinel*:

> *... the [Hospital fitness] center is being built to compete with other fitness centers, and officials hope to create a membership based primarily of young and middle-aged families... members can expect to pay membership fees comparable to other privately owned fitness centers — and with a descending scale for additional family members. The center also hopes to attract occasional users who could pay fees for each use.*

- Joe Moore, owner of Moore's Fitness World, learned that the City of Vandalia, Ohio, was considering opening a city-run recreational center. While park and recreation officials generally deny that their facilities compete with the private sector, the city-commissioned feasibility study showed that the public facility would compete directly. The study states:

> *We believe that this group of current fitness members represents a good base of support for future community center uses, as well as providing a base for future estimates of the number of potential regular uses of the health and exercise portions of the facility.*

Why should tax-paying clubs have to operate with a handicap equal to 16 percent of their gross income? Why should tax-exempt organizations be allowed to plow these funds into further improvement of their clubs, a step that only increases their competitive advantage? Why are local, state, and federal governments denied the taxes generated by these nonprofits' commercial operations? Why are we allowing our community tax bases to be eroded by a tax-exempt sector that has grown from representing less than six percent of the gross domestic product in 1975 to 10 percent in 1990?

Former Texas Representative J.J. Pickle, who spent years working to solve the problem of unfair competition while chairman of the House Ways and Means' Oversight Subcommittee, has an answer to our questions about why nothing has been done to date to stop this. He recently told *U.S. News and World Report,* "The big problem is that we

have grown accustomed to creating nonprofits, and they are part of the tax dodge. They get so big that nobody can touch them politically" (October 25, 1995, page 39).

America must wake up and expose tax-exempt organizations when they act inappropriately, **JUST AS WE MUST EXPOSE THE INAPPROPRIATE ACTIVITIES OF TAX-PAYING BUSINESSES.** The quality, tax-paying health club industry itself must rid the industry of those who do not operate ethically. The tax-paying health club industry must take a more holistic approach so that it develops and stimulates programs and facilities that address the preventive health, social and recreation needs of all ages and economic groups.

By the same token, elected officials like you should insist that Americans create a dynamic new era of cooperation and collaboration among the public, private and nonprofit sectors — an era of cooperation that results in building a community's tax base, providing better services to those not likely to be served via traditional market facilities, and giving significant financial support for the appropriate activities of nonprofit organizations that deserve subsidy.

Let me propose for your consideration a model that has worked in Harford County, Maryland. I have personally worked with this model. I believe it can be used throughout the country, given the presence of quality tax-paying health club operators and government and nonprofit officials who insist on promoting cooperation and collaboration and refuse to ignore the realities of unfair competition.

In 1990, I discovered by chance in an article about the local YMCA that their strategic plan called for them to build a YMCA in the very market area we had been serving for 10 years. We formed a coalition of small business owners to educate the public about the need for a level economic playing field. We also discussed the proper role for government and nonprofits to provide services that cannot be market-based. Finally, we detailed how the business, government and nonprofit sectors should work together to find common ground. We succeeded!

Six years later we have expanded the size of our club from the original 25,000 sq. ft. to our current 90,000 sq. ft.; donated the gymnasium at the new Boys and Girls Club in Aberdeen, Maryland (home of Cal Ripken, Jr., our most famous Harford County citizen); and we are working in concert with Lee Jensen, the very thoughtful and capable Chief Executive Officer of the YMCA of Central Maryland, and his staff to build models of cooperation and partnership throughout Harford County, Maryland. In fact, next month we are jointly sponsoring two events for teenagers — a bike trip and a canoe trip.

There are other models of cooperation — though far too few — that we should study. In East Longmeadow, Massachusetts, earlier this year the local Y made plans for a cooperative arrangement with a regional tax-paying health club (New England Health and Racquet) to lease space for a teen center within the health club property, thereby creating a positive synergy rather than a competitive situation.

Let me conclude by leaving you with five specific recommendations. Specifically, Congress should do the following:

1. Require the Treasury Department to provide a public estimate of revenues lost through avoidance of unrelated business income tax (UBIT).
2. Require the Treasury Department to provide a public estimate of potential new revenues to the Treasury if the UBIT law were expanded to require all commercial operations of nonprofits to pay their fair share of taxes.
3. Develop tax legislation that insures that all commercial activities of nonprofit organizations are taxable.
4. Urge the General Accounting Office (GAO) to determine the extent to which nonprofit health and fitness centers operated by YMCAs and nonprofit hospitals actually serve needy individuals and charitable classes.
5. Encourage at the federal, state, and local levels the adoption of IHRSA's *Fair Competition Guidelines* (see attached) that will reduce instances of direct unfair competition between tax paying businesses on the one hand and nonprofit organizations and government agencies on the other.

Two of these specific Fair Competition Principles are worth noting here.

FAIR COMPETITION PRINCIPLE #5

Before seeking approval for the use of tax-exempt or public funds to construct health clubs, tax-exempt organizations and government agencies should commission an objective study that details the

economic impact on an existing tax paying business located within 15 miles of the proposed project.

FAIR COMPETITION PRINCIPLE #6

Prior to any use of a tax-exempt privilege or government loan guarantees or funding to construct and/or operate fitness facilities, every avenue should be pursued to identify alternative means of meeting the projects' objectives that would result in increasing the tax base of the local, state, and federal governments. [©1996 *The Case for Fair Competition in the Fitness Industry,* 2IHRSA, 226 Summer Street, Boston, MA, 02210. 1-800-228-4772]

Let me leave you with these final thoughts:

My dream for the tax-paying health club industry is that in ten years there will be thousands of community- and family-oriented tax-paying clubs like the Bel Air Athletic Club across the United States providing health and recreation services to their communities, while helping these communities and the nation build their tax base.

My dream for our country in this regard is that public and elected officials, business leaders, and the staffs and volunteers of nonprofit organizations will consciously promote collaborative efforts that result in making the best use of scarce resources,

enhance the communities' tax base, and provide access to services for those who cannot receive them without public intervention.

Initiative and encouragement by elected officials such as you and specific directives by Congress will go a long way in making an important difference in the next century. A difference that will contribute significantly toward: (1) increasing our communities' tax base; (2) ensuring that small business does not face unfair competition from the government or nonprofit sectors; and (3) making certain that the mission, strategy and daily activities of all of our nation's nonprofit organizations are appropriate.

Each and every one of us who cares about promoting good public policy for the long term in regard to this significant issue of Fair Competition has a vested interest in planting the seeds of change NOW. This great country of ours will be much better off.

On behalf of all the members of IHRSA, I thank you for the opportunity to present our views this morning. We appreciate the interest you and your colleagues have shown for creating a more level playing field for the health and fitness industry.

Thank you for taking the time to listen.

Respectfully submitted,

Roger S. Ralph, President

Bel Air Athletic Club, Harford County, Maryland

and

Chairman, Fair Competition Committee

International Health, Racquet and Sportsclub Association (IHRSA)

ATTACHMENT A: IHRSA CODE OF CONDUCT

As a member of IHRSA, we consider it our mission to enhance the quality of life through physical fitness and sports. To this end, we endeavor to provide quality facilities, programs and instruction. We further strive to instill in those we serve an understanding of the value of physical fitness and sports to their lives.

In order to fulfill our mission, we pledge the following:

- That we open our membership to persons of all races, creeds, and places of national origin;
- That we treat each member as though the success of our club depends on that individual alone;
- That we systematically upgrade our professional knowledge and keep abreast of new developments in our field;
- That we design our facilities and programs with the members' safety in mind;
- That we continue to increase the value and benefits of our services and programs;
- That we provide public service programs to expand awareness of the benefits of regular exercise and sports;
- That we deliver what we promise; and
- That we agree to conduct our business in a manner which commands the respect of the public for our industry and for the goals toward which we strive.

ATTACHMENT B: IHRSA MEMBERSHIP PLEDGE

As a member of IHRSA, I agree to operate my clubs in the best interest of the consumer and the industry b:

- Abiding by all local state, or federal consumer-protection legislation and all other applicable laws;
- Placing all presell membership fees in escrow in a segregated account;
- Refusing to sell prepaid lifetime memberships;
- Not guaranteeing membership or renewal fees beyond a three-year period or the period permitted by applicable law;
- Refusing to engage in deceptive, high-pressure sales tactics;
- Opening membership to persons of all races, creeds, and places of national origin;
- Operating my club(s) in accordance with the principles outlined in the IHRSA Code of Conduct.

Business Coalition for Fair Competition

Unfair Nonprofit Competition With Small Businesses

House Committee on Small Business
July 18, 1996

Business Coalition for Fair Competition 1996

ACIL (Formerly the American Council of Independent Laboratories)
American Bus Association
American Society of Travel Agents
Colorado Coalition for Fair Competition
Helicopter Association International
International Association of Environmental Testing Laboratories
International Hearing Society
IHRSA The International Health, Racquet and Sportsclub Association
Management Association for Private Photogrammetric Surveyors
NARD National Association of Retail Druggists
National Association of RV Parks and Campgrounds
National Burglar and Fire Alarm Association
National Child Care Association
National Tour Association
Professional Services Council
Society of Travel Agents in Government
Small Business Legislative Council
Textile Rental Services Association
United Motorcoach Association

Statement by
Thomas J. Scanlon
Vice Chairman
Business Coalition for Fair Competition
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Annandale VA 22003
Phone 703 280 4622
FAX 703 280 0942

Madame Chairman and Members of the Committee:

The Business Coalition for Fair Competition is a twelve-year-old alliance of trade associations and small businesspeople united in opposition to the extraordinary and extensive advantages nonprofits have in the commercial market place.

We seek an even playing field. We are not opponents of universities, hospitals, museums or others among the nation's 1.4 million non-profits. On the contrary, many of us work with them on various community projects and we recognize the important role they play. Rather than criticize non-profits as entities, we simply object to certain special privileges and advantages they have been granted by government.

These advantages come directly or indirectly from Federal, state and local governments. We appear before you today to talk about what the Congress can do, because our efforts to talk reason with tax exempt organizations have been fruitless. For over a decade we have seen them redouble their determination to vigorously increase their sales and marketing of commercial products and services at the expense of small businesses. They lobby to defend the government-given privileges they have. They seek new privileges.

Since no voluntary relief has been offered, we turn to Congress to urge reconsideration of the many ways in which government has contributed to the problem.

White House Delegates Urge Congress To Act. On this issue, the business community has sought help from Congress in the past: The delegates to the 1986 and 1995 White House

Conferences on Small Business ranked this issue among their top fifteen recommendations to the President and Congress.

Of 434 issues in 1995, the following recommendation by 1,800 elected and appointed delegates was one of their top fifteen:

> Government and Nonprofit Competition
> Support fair competition: Congress should enact legislation that would prohibit. . .tax-exempt and antitrust-exempt organizations from engaging in commercial activities in direct competition with small businesses. (NCRA #144: page 26 "Final 60 Recommendations" *Foundation for a New Century: A Report to the President and Congress*, by the White House Conference on Small Business, September 1995.)

This recommendation originated at the state level where delegates complained tax-exempt organizations and state, local and Federal agencies are major competitors for many small businesses.

This Committee held hearings on these issues earlier this decade.

In the last decade, the House Ways and Means Committee held hearings and considered a subcommittee plan dealing with reform of nonprofit tax laws. Reform of the tax laws affecting the commercial activities of non-profits is long overdue.

Meanwhile the nonprofit sector of our economy has grown far faster than the small business sector.

Tax-Exempts Are Growing Rapidly. "In current dollars, total revenue and expenses of all nonprofit charitable organizations, including private foundations, grew from less than 4 percent of GDP in 1975 to nearly 8 percent in 1990," according to Internal Revenue Service.[1]

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[1] Statistics of Income Bulletin, published by the Internal Revenue Service, Summer 1994, Page 83. Daniel F. Skelly, then acting director of Statistics of Income, Internal Revenue Service wrote in "Tax-Based Research and Data on Nonprofit Organizations, 1975-1990" that "revenues and expenses of tax-exempt organizations

While U.S. Gross Domestic Product grew 52 percent between 1975 and 1990, assets of tax-exempt organizations increased in real terms by over 150 percent and nonprofit revenues increased over 227 percent.[2]

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each represented 10 percent of the gross domestic product (GDP), up from less than 6 percent for 1975." International Journal of Voluntary and Non-Profit Organizations, Manchester University Press, 1993.

[2] Year	Gross National Product	Non profit income	Legal services income
1930	$90.4billion	$649 million	$683million
1935	72.2	528	624
1940	99.7	599	719
1945	211.9	933	930
1950	284.5	1.803 billion	1.344billion
1955	398	2.675	1.926
1960	503	3.870	2.636
1965	684.9	5.306	4.069
1970	977.1	8.411	6.426

During this period the Gross National Product grew 980%, nonprofit income grew 1196%, legal services to the public and businesses by law firms and attorneys grew 841%. During the same period, despite the boom in US travel and tourism, the hotel/motel business grew only 629 percent trailing the growth of GNP, legal services, and nonprofits.

The nonprofit sector income soared after World War II becoming the fastest growing single sector of the national economy.

The number of nonprofits has soared in the past fifteen years. In the United States, it is very easy to form a nonprofit. The benefits (tax exemption, lower mailing rates, etc.) are so attractive, there is no wonder that more and more nonprofits are springing up.

This chart shows the growth of the nonprofit sector:

	1975	1982	1983	1985
# of Returns	82,048	75,738	89,052	106,449
Assets	$108.5B	279.6B	331.2B	423.5B
Dues received	$1.5B	2.5B	3.1B	3.8B

This chart also reflects the growth in the number of nonprofits with income large enough to require filing an income tax return. But, it shows that growth has not come from dues--a line item which has grown very slowly over the years. Instead, much of the growth comes from business activity--the commercial sale of products and services by nonprofits.

The IRS "approved a record 46,887 applications in the year ended September 30 from organizations seeking tax-exempt status. That was up 7% from 1993 and 21% from 1991. . .The total number of tax-exempt organizations. . .up about 15% from 1989. . .only 14,384 of these organizations reported 'positive unrelated business taxable income,' totaling $431.1 million, up 11% from 1990."[3]

Tax-Exempt Income Growth: From Sales. The Internal Revenue Service reports that non-profit growth has largely been generated by the sale of products and services: "In terms of revenue, program service revenue--the fees collected by organizations for the programs operated in support of their tax-exempt purposes--was the major source. Overall, it continued to account for 70 percent of total revenue for 1991. Some examples. . .fees collected by museums, YMCA/YWCA activity fees. . .The largest asset-size organizations, those with assets of $50 million or more, relied on program service revenue for 76 percent of their total. Contributions, grants, and gifts were. . .18 percent of the total received."[4]

Between 1975 ($2,695 billion) and 1985 ($3,618 billion), the GNP had grown an annual average of 3.4%, but nonprofit assets grew an annual average of 10.9%, and contributions grew 7.5% during the same period.

Historical Statistics of the US, Colonial Times to 1970, US Department of Commerce, Bureau of the Census, p. 839 T 1-14 National Income Originating in Distribution of Selected Services Industries.

[3] "Growth Industry: Tax-exempt organizations proliferate," Wall Street Journal, August 30, 1995, p. 1.

[4] "Charities and Other Tax-Exempt Organizations 1991" by Cecilia Hilgert, Statistics of Income Bulletin, published by the Internal Revenue Service, Summer 1995, page 27. In the Spring 1995 edition "Exempt Organization Business Income Tax Returns, 1991" the IRS reported "Organizations filing a Form 990-T, Exempt Organization Business Income Tax Return, accounted for less than 3 percent of the population of tax-exempt organizations to which the unrelated business income tax provisions applied. . .Only 1 percent of all filers, 433 organizations, had gross Unrelated Business Income (UBI) of $1,000,000 or more, but they accounted for nearly half of all gross UBI reported and 64 percent of total tax liability," by Margaret Riley, Internal Revenue Service, Statistics of Income Bulletin, Spring 1995, page 38.

The growth of the nonprofit sector, including the rise in executive compensation, was documented in a report to Congress by the General Accounting Office.[5]

The expansion of tax-exempts into selling business products and services was first reported by researchers in the 1980s. For example, in 1981, Dr. Henry Hansmann, Yale University, wrote:

> ". . .the nonprofit sector represents a substantial and growing share of the national economy. . .Nonprofit firms now commonly provide goods and services in direct competition with profit-seeking firms, and are in many cases coming increasingly to resemble their for-profit competitors in their manner of organization and operation."[6]

Former U.S. Representative James J. Pickle after chairing hearings on the business activities of nonprofits said "I think we have to admit that once a tax-exempt organization gets on the books, it stays there forever, until Gabriel blows his horn." And former Representative James H. Bilbray, who also chaired Small Business subcommittee hearings on this subject, said "And once a charity gets on the list, there's no periodic assessment by the IRS to see whether it's performing to a suitable standard." IRS Commissioner Margaret M. Richardson said "In recent examinations of large public charities, we are finding patterns of abuse that cause us concern."[7]

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[5] "Tax-Exempt Organizations: Information on Selected Types of Organizations," General Accounting Office, February 1995. (GAO/GGD-95-84BR). The reports states that between 1992 and 1994, out of over one million, the Internal Revenue Service revoked the tax-exemptions of 67 organizations. "IRS was unable to provide us with the specific reasons for these revocations," GAO said. The Subcommittee on Oversight, House Ways and Means Committee, proposes that IRS be required to disclose the reason for revoking an organization's tax-exempt status. The Business Coalition for Fair Competition endorses this proposal.

[6] "The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation," by Henry Hansmann, Ph. D., Institute for Social and Policy Studies, Yale University, February, 1981, p. 1.

[7] "Too Charitable to Charities? Why Congress should get tough on America's $400 billion charity industry," John Kimelman, FW, September 1, 1994, pp 46-50.

News Media Pinpoints Need for Action by Congress. The clash between non-profits and the business community has prompted growing news media coverage.

"The Internal Revenue Service does not have enough money or employees to monitor and regulate non-profit groups effectively" James J. McGovern, former Assistant Commissioner for Employee Plans and Exempt Organizations told the American Bar Association's Tax Section. "In the 1970s the IRS issued more than 100 revenue rulings that directly affected charities. In the 1980s, the number dropped to 22. In the early 1990s, the service did not issue any revenue rulings on matters that affected charities," he said.[8]

"Businesses are entitled to a level playing field, and Congress and the IRS should see to it that the profits of nonprofits are taxed just like the profits of regular businesses. . .By throwing around their weight in Washington, nonprofits have moved out of the shadows into the glare of the political process. They deserve the scrutiny they are now attracting," comments an editorial in Business Week.[9]

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[8] "IRS Said to Be Too Weak to Regulate Charities," The Chronicle of Philanthropy, June 27, 1996.

[9] "Nonprofits' Fat Profits", Business Week, July 3, 1995. The editorial raises this question: "Are loophole-ridden, laxly enforced tax laws giving nonprofits an unfair edge over for-profit businesses? Some nonprofits may be abusing tax exemptions and low postal rates to beat the heck out of competitors instead of bolstering the commonweal. One YMCA in Washington, D.C. has a virtual reality golf course, shines its members' shoes while they work out, and charges monthly dues of up to $98. Other nonprofits are selling tax-exempt bonds that may also help their commercial activities. Unfair? Rivals sure think so."

The same issue of Business Week contains an article titled "It's Open Season on Nonprofits: Their ringing cash registers have Washington up in arms" by Paul Magnuson, July 3, 1995, page 31. The article states "To pull in dollars, nonprofit hospitals are establishing lucrative laboratories, nursing homes--even health clubs. Universities take in laundry from local restaurants. Museums open lavish shops selling designer ties. Environmental groups market affinity credit cards and bank checks imprinted with dolphins and whales. . .(H)ospitals can call their fancy gyms 'physical rehabilitation centers' and sell corporate memberships."

Earning higher net income has encouraged nonprofits to reward chief operating officers with substantial salaries. The Chronicle of Philanthropy reports:

> "The largest charities are not backing away from high salaries for chief executives, even in the face of embarrassing scandals and increased scrutiny of non-profit finances. In fact, salaries have been going up. A Chronicle survey of 184 organizations has found that 154 of them paid at least one top executive more than $100,000 a year. And 83 gave at least one official more than President Clinton's $200,000 salary. . .Ironically, some non-profit leaders say, scandals are driving salaries higher."[10]

The Washington Post reports "From selling fresh produce to promoting wines to delivering caviar to arranging event management, regional charities have launched some very pin-stripped fund-raising."[11]

As the New York Post says "A tax-exempt group like the YMCA has a considerable edge: exemption from federal, state and local income taxes; in most states, exemption from sales tax; in most cities, exemption from property taxes; a 50% discount on postal rates and tax-exempt financing. . .For-profit ventures can help fund a non-profit group's charitable mission. But in some cases the ventures backfire, draining money instead."[12]

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[10] "Big Salaries Just Keep Going Up" by Susan Gray and Elizabeth Greene, The Chronicle of Philanthropy, September 7, 1995, p. 1. The New York Times also ran a story about nonprofit salaries "Large Charities Pay Well, Survey Finds: Highest Salaries Go to Chief Executives of Metropolitan Hospitals" by Karen W. Arenson, September 18, 1995.

[11] "Businesses Object to Charities' Lucrative New Ventures" by Tracy Thompson, The Washington Post, August 30, 1995, p. A 1. The Post interviewed Marc Owens, IRS Director for exempt organizations who pointed out ". . .the number of court cases is tiny compared with the number of nonprofits. There are about 1.2 million tax-exempt organizations registered with the IRS, Owens said, but the IRS routinely audits fewer than 10,000 a year. It tends to target the bigger nonprofits first, Owens said, because of the potential tax loss their activities could represent." The Post quotes Goodwill's Executive Director Dave Becker as saying "Nonprofits are going to have to get an awful lot better at what the business world has known about for years--the generation of wealth. Everybody knows the handwriting is on the wall."

The Philadelphia Inquirer reports "Thanks to Congress, there's a vast pool of cheap money available if you're a nonprofit organization. It's called tax-exempt bonds. All you have to do is convince a public authority to issue tax-exempt bonds for the nonprofit buyers to finance the purchase. And your associates get to serve as underwriters in the bond sale, earning $8 million in fees. Sounds too good to be true? It's true. . .Hospitals, nursing homes, colleges and other nonprofit organizations can tap into this seemingly endless stream of cash."[13]

The Boston Globe reports that the Knights of Columbus, viewed as a charity by most, is actually one of the nation's largest insurance companies: "The Knights are one of the nation's fastest-growing life insurance companies, consistently outperforming averages for the top 25 firms. In 1993, the Knights took in $1 billion in revenue and received top ratings from the industry's rating agencies. . .largely because of its enormous $577 million surplus."[14]

USA Today, in an editorial titled "How non-profit groups make money, avoid taxes; Our view" states ". . .the bottom line is non-profits earned scrutiny by going commercial with business ventures that just keep growing and growing--at taxpayers'

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[12] "How The YMCA Got $0; Rivals: Tax exemption an unfair edge" from the second in a three-part series titled "Free Ride: The 'Non-Profit' Groups", New York Post, September 6, 1995, p. 16. The New York Post also said: "Few organizations have mastered the art of tax-free commercialism better than the Metropolitan Museum of Art. Its museum shop is a great place to find high quality, sophisticated and unusual gifts--if you can afford it. The stuff is pretty pricey. . .In general, tax-exempt organizations must pay taxes on for-profit ventures. But there is a loophole in the law that allows the museum and other non-profits to save millions: If the commercial venture somehow related to the organization's mission, it's tax exempt. That makes it possible for the museum to avoid paying taxes on Degas coffee mugs and Monet umbrellas."

[13] "For nonprofits only: A cheap pool of money" by Gilbert M. Gaul and Neill A. Borowski, The Philadelphia Inquirer, part of a six-part series, April 23, 1993.

[14] "Doing Good and Doing Well: Both Charitable and Commercial, the Knights of Columbus Are Prospering" by James L. Franklin, Meg Villancourt and Patricia Wen, The Boston Globe, part of a two part series, April 2, 1995. The Globe reports that the CEO of The Knights earns $524,000 per year plus a $95,000 Mercedes, a private chauffeur and an apartment in Rome, Italy, and runs the business from a 23-story tower in downtown New Haven, Ct.

expense. . .Profit centers are supposed to pay an 'unrelated business income tax.' But it doesn't work. The IRS collected $116 million in 1991, the last fully audited year. That's peanuts compared to their revenues. The non-profits' tax exempt status helps them undercut competitors who pay taxes. And when those competitors lose business, taxpayers pay the price."[15]

The USA Today editorial concluded by recommending to Congress:

> "Tax all non-profits' commercial ventures like other businesses. Non-profits then could still take in donations and earn interest tax free, and make money like any business. Only they'd pay taxes on their profits, rather than stick other businesses and taxpayers with the bill."

AARP $135 Million Payment to IRS Highlights Size of Non-Profit Business Sales. When the American Association of Retired Persons agreed to pay the Internal Revenue Service $135 million for business profits earned 1985-1993, they refused to admit they owed taxes. AARP settled "because the board just figured it would be . . .most cost effective, easier, to get the whole thing behind us," according to AARP spokesman Peter Ashkenaz.[16]

This was the biggest single tax payment by a nonprofit in US history. Like many other nonprofits, AARP went many years flagrantly skirting the Internal Revenue Code.

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[15] "How non-profit groups make money, avoid taxes; Our view" USA Today, June 20, 1995, p. 10A.

[16] "AARP settles large IRS claim" by the Associated Press, Washington Times, August 31, 1994. IRS claimed AARP owed the money based on net profits from sale of prescription drugs, insurance, and other products and services. The article states that AARP "had an operating revenue of $369 million last year, more than half of it from fees earned by selling and promoting products." AP reported that AARP had $19.6 million in reserves following the settlement with the IRS. On May 3, 1995, Senator Simpson of Wyoming said his investigation of AARP points up a need for "a complete overhaul of our nonprofit business tax enforcement" and might lead him to propose ending tax exempt status for organizations that receive less than 75% of their revenue from dues. Simpson said AARP receives $86 million in federal grants. (Congress Daily, May 3, 1995, p. 5.)

The rules are vague enough for them to argue against the IRS. The enforcement is weak enough that AARP and hundreds of other nonprofits are never audited or refuse to agree with the IRS.

Had AARP commercial operations been the "for-profit" corporation they appear to be, a Federal indictment would have put the AARP CEO in Federal prison and the "company" into bankruptcy. But, the Federal government cuts the non-profits a lot of slack. There is no such slack for small businesses. Yet the two are pitted together in head-to-head competition.

Examples of Abuse by Nonprofits

Giant Non-Profit "Company" Becomes Two Non-Profit Companies. In 1995, the Washington Post correctly predicted that nonprofit Mitre Corp. would split into two companies. In January 1996, Mitre issued a news release explaining how it would divide into two tax-exempt 501(c)(3) "charities." Dr. James Schlesinger, Mitre Board Chairman, said the split will enable Mitre to focus on its work as a Federally Funded Research and Development Center (FFRDC) serving the Department of Defense and the Federal Aviation Administration. One of the biggest nonprofits in the country, Mitre employs 4,500 people. The new nonprofit, to be called Mitretek Systems, will manage Mitre's sales to federal, state and local government. Mitretek Systems will employ 750 people and sell to the FBI, General Services Administration, the US Postal Service, State of Maryland, Department of Commerce, Department of Transportation, and the Department of Energy.[17]

Mitre liberally refers to itself dividing into "two companies" and sells to the same customers served by dozens of for-profit companies. Mitre looks like a for-profit business. It acts like a for-profit business. It even calls itself a "business."

However, nothing could be further from charity than Mitre and Mitretek Systems. No entity is less deserving of the 501(c)(3)

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[17] "Mitre Weighs Severing Nonmilitary Unit" by Kathleen Day, The Washington Post, September 22, 1995, p. C 3. "Mitre Divides Into Two Companies," Mitre News Release, January 29, 1996.

status than these operations. Mitre has enjoyed non-profit status since 1958 and is one of eleven federally-funded research and development centers selling $1.25 billion in services to government. Congress should insist on taxation for all Mitre and Mitretek Systems net income. The IRS should promptly consider rescinding the 501(c)(3) status for both these organizations. To put Mitre in the same league as the Make a Wish Foundation is a substantial and gross violation of the spirit of the 501(c)(3) designation.

Non-profit Battelle Loses Battle with Justice Over Misuse of Government Equipment. The Battelle Memorial Institute has agreed to pay the US government $330,000 as a penalty for using government-owned spectrometry equipment in its services to commercial customers. Its Federal contract prohibited the use of Federal equipment for commercial work. Battelle was accused of making a false claim under the False Claims Act and faced treble damages for each false claim.[18]

Battelle is paid $500 million per year by the Department of Energy to operate the Pacific Northwest Laboratory. The abuse was found by the Department's Inspector General in 1992.

The National Science Foundation has a general prohibition against grantees and contractors using equipment purchased with Federal funds for commercial purposes. The Coalition recommends that this rule be made government wide to be enforced by all agencies.

Alaska Medical Non-Profit Enters the Aviation Service Business. The Southeast Alaska Regional Health Corporation (SEARCH) is a nonprofit medical provider in Alaska. It receives 70 percent of its revenues from Federal and state taxpayers.

Although the vast area covered by SEARCH was served by private aviation operators (with which SEARCH previously contracted), SEARCH decided it could make more money by

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[18] "Battelle Agrees To Pay U.S. $330,000 for Misusing DOE Equipment," U.S. Department of Justice News Release, June 3, 1996.

purchasing a private helicopter and fixed-wing operation[19] to meet its own air-transportation needs plus sell services to the public.

In June, 1995, five private air-transportation operators, each one of them a small business, complained to their federally elected officials about the unfair competition posed by SEARCH.

Five months later, the Indian Health Service (part of the US Department of Health and Human Services) said "SEARCH will utilize this air carrier for administrative and medivac purposes only; it will neither offer nor solicit non-company passengers for profit as mentioned by your constituents."[20]

Within a few weeks of assuring Senator Stevens the group would not solicit public business, Mountain Aviation, now owned by SEARCH, placed a newspaper ad in the Sitka Sentinel soliciting passengers for the Christmas travel season.

They also advertised in the Sitka Yellow Pages (Airlines, p. 7) and in the lobby of the Sitka Airport.[21]

The Business Coalition for Fair Competition urges Congress to prohibit Federal grant recipients, either directly or through their subsidiaries, from competing with private enterprise. Nonprofits should neither use equipment purchased with federal funds, nor personnel paid for in part or in whole with federal funds, nor the apparent "endorsement" by the government as a business advantage. These advantages are not available to small businesses. They should not be used to hurt small businesses.

Fairfax University Does Work of a High Tech Firm. George Mason University, Fairfax County, has been awarded a contract

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[19] Mountain Aviation, Sitka, Alaska.

[20] Letter from David Keal, Health and Human Services, Indian Health Service, Office of Economic Development Director, to Senator Ted Stevens, November 9, 1995.

[21] Copies of the airport advertising have been obtained by the Helicopter Association International, Alexandria VA, attn: Bill Wanamaker 703 683 4646.

to design and build two multimedia information kiosks. Eventually, the kiosks will take credit cards. Kiosks are designed to be used in libraries.[22]

Because of the growth of the multimedia business in the United States and in the Washington DC market, there are many private companies in the kiosk business. Awarding such a contract to a tax-exempt university denies opportunities to small high-tech firms and is an abuse of the university's non-profit status.

Non-Profit Hospitals Enter Health Fitness Club Business. According to the Association of Hospital Health and Fitness, over 200 fitness clubs in the United States are owned or operated by hospitals. Seventy-three percent of hospitals are not-for-profit. Sixty percent of hospital centers with more than 70,000 square feet are for-profit. "Our survey covered the gamut of hospital health and fitness centers, ranging from small clinically oriented ones to large, state of the art centers that produce sizable cash flow."

"Larger centers reported significant returns on investment. . . Hospital centers are proving that they can attract and maintain members at prices slightly higher than those prevailing in private clubs in their market. Health-related services, staff expertise, and a hospital's stability affect consumer willingness to pay higher prices." Most of the hospital owned health clubs have 1,999 members or more.[23]

Tax-exempt hospitals often compete head-to-head with local small businesses, not only in the health club business but in the hearing aid, eye wear, drug sales, and orthotic device businesses. The Commonwealth of Virginia monitors the businesses of all hospitals and many Virginia non-profit hospitals have entered non-hospital businesses.

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[22] Memo to the Board of Supervisors, June 26, 1995, p. 111-112

[23] "Industry Overview: Hospital Health and Fitness Centers 1991-1994" Survey and Directory, Second Edition, Association of Hospital Health and Fitness.

Nonprofits are quick to spot lucrative markets where they can make money. But when it comes to soliciting contributions, they advertise their "nonprofit" status.

It is time for Congress to say "No" to non-profit fitness clubs which compete with small businesses. It is time for Congress to insist on taxes from all non-profit business ventures; if it's business it ought to be taxed like business--no double standard.

To do less leaves an unfair marketplace where unfairness derives from Federal tax policy. To do less leaves the small business owner paying taxes to subsidize tax exempt competitors.

The fact that for-profits have to go to court against nonprofits, as in the case of National Environmental Testing against the University of Iowa's State Hygienic Laboratory, underscores the failure of the current tax code to define a clear bright line declaring what nonprofits can and can't do with their exemptions.

Nonprofit "Sales" Can Dominate A Market. While the current rules allow a nonprofit to conduct a single sale of products and services, in some industries *repeated* sales by tax-exempt organizations can dramatically affect the opportunities of small businesses.

Take for example, the nation's flower shops. Every event inspires nonprofits to sell flowers and plants so that cumulatively over a year every major day of recognition is served by the tax-exempt sector. Churches and schools sell wreaths, trees, and poinsettias for the December holiday period, flowers for Valentines Day, flowers for Easter, bedding plants for spring, flowers and houseplants for Mother's day, flowers for prom and graduation parties, hanging baskets for summer, plants for Halloween, etc. They erect tents on their tax-exempt property to make tax-exempt profits at the expense of the local small business. Some churches sell flowers for all weddings in their facility.

A flower shop in Midland, Michigan complains "I do have a great problem with them riding the wave at holiday times and

competing with us on uneven ground, where they show up and dump their product. . .we have actually had people try to bring back 'Lions' roses only to have to explain to them that we are in no way involved."[24]

"We used to sell bundles of flowers to the schools and different organizations on holidays and now the florists are totally cut out and I question if the school organizations fall into this tax-exempt group," writes Margaret Werth, Nature's Own Florist, Modesto, CA July 4, 1995.

"I feel strongly that some Congressional legislation is needed to control such tax-exempt groups from taking business away from the small local businesses," states Billie at Rosewood Florist, Centralia, MO July 3, 1995.

The sale of Christmas trees was a big issue in Cheshire, Connecticut. The town of Cheshire bought a 38-acre tree farm and sold 1,000 Christmas trees. "Area farmers howled, collecting about 800 signatures on a petition protesting what they charged was blatantly unfair competition."[25]

This same town established the Cheshire Music School to sell music lessons at $180 per period. Guitar lessons cost $50. The school will use 30 instructors under the direction of the department of parks and recreation. Should any town or nonprofit corporation be free to establish a music school in competition with local teachers and groups of instructors? Should the net income from this school be taxed as if the entity were a for-profit business?

Nonprofit Opens Travel Agency. In 1995, the American Association of Critical-Care Nurses opened a wholly owned travel division called Travel Matrix. According to Association Trends "AACN is also offering its travel division services to

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[24] Mark M. Smith, Smith's of Midland, Midland, MI, July 5, 1995.

[25] "Cheshire businesses cry foul as town enters new ventures" Hartford Courant, September 17, 1995, page H 2.

other trade and professional associations needing the services of a travel agency that caters to the needs of nonprofits."[26]

Hot Spot Doubles as Fire Station. This Spring, the City of Fairfax VA opened a Fire Station which is also "available for Weddings, Parties, Receptions, Conferences, Bingo, Sporting Events. . .you name it! We want to talk to you about your conference or event needs." The site is called Fairfax Volunteer Fire Department, Station 3 and Williams Memorial Hall. They have "a brand new look" their full page advertisement states.[27]

YMCAs Insist on Clashing With Private Fitness Clubs. While the YMCA of Greater Washington was moving into Fairfax County with a 50,000 square foot state of the art facility on land donated by the Fairfax Board of Supervisors, the YMCA of Greater St. Paul was opening a new 43,000 square foot fitness facility. Both will compete with existing for-profit clubs within a mile.[28]

YMCAs offer far more than fitness such as tours, seminars, and retail sales. While formed as a "charity," the YMCAs perform little charity. Rather, they concentrate on providing lucrative fitness facilities for middle and upper income citizens. While the Y claims to be different, their advertising, facilities, rates,

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[26] "Association Opens Travel Division," Association Trends, June 23, 1995, p. 6.

[27] Advertisement in The Connection, April 4-10, 1996, p. 27.

[28] "The exemption privilege: Taxpaying businesses argue that nonprofits have unfair advantage," City Business, January 5, 1996, page 1. This article also cites the Minnesota Public Radio as "one of the nation's most successful broadcasting concerns."

"Some commercial broadcasters have complained about what they consider nonprofit broadcasters' unfair advantage. . .Wayne Eddy, owner of 1,000-watt KYMN-AM in Northfield. . .points out that MPR takes in millins from the sale of a wide range of books, tapes and other materials through its for-profit, taxpaying subsidiary, Greenspring Co. When MPR is begging and pleading for money, Minnesotans should be aware that they are a fat-cat organization. The dollars should go to the really needy organizations, Eddy said. They now own 28 broadcast properties, and by using all of those frequencies they deny people (other broadcasters) access."

locations and hours of operation demonstrate that they are targeting the same market as commercial clubs.

The nonprofit YMCA is today the largest provider of fitness in the nation.

Universities Use Name to Sell Health Newsletters. Because they have well-know medical centers, several nonprofit universities are selling health newsletters to the public. They promote not to alumni but to lists obtained from American Express, magazine publishers, and others. They publish articles which are usually not associated with the medical school, its teachers, doctors, specialists or researchers. These nonprofit newsletters include:

University of California at Berkeley School of Public Health Wellness Letter. The letter's "subscription department" is in Palm Coast, Florida, and is paid for by 500,000 subscribers. The promotional literature does not state the remote relationship between the newsletter as a commercial venture and the university.

The Harvard Heart Letter is published by the Harvard Medical School Health Publications Group and comes "straight to your door from the Harvard Medical School complex in Boston." Whereas the University of California advisory board is from the university, none of the Harvard advisors are from the university. "We have created a newsletter that brings you the best latest developments and breakthroughs involving heart health--including the most exciting new techniques, treatments and medications being tested and used at the Harvard Medical School" the Editor claims. The Harvard promotional material states that the newsletter is endorsed by Ann Landers.

The Mayo Clinic Health Letter is advertised like most nonprofit newsletters by use of the non-profit mailing rate. Based on the sales literature, it also appears to be endorsed by Ann Landers plus US News and World Report, and Money Magazine. Conceding that the newsletter makes a profit, Mayo promises that the "proceeds. . .are used to help fund Mayo's medical research and education programs. No promise is made that any of the material in the newsletter is written by a doctor

associated with Mayo. However, the promotional material promises that "You'll have the added peace of mind knowing the advice of Mayo's medical experts is at your fingertips the moment you need it."

Other publishers of nonprofit health newsletters include Johns Hopkins University and the Center for Science in the Public Interest.

Nonprofits Seek New Privileges. As an example of how the nonprofits seek new privileges, a coalition of universities, museums, and nonprofit societies has petitioned the Internal Revenue Service to make most nonprofit travel and tour activities tax exempt. Current law defines "unrelated trade or business as:

"any trade or business the conduct of which is not substantially related. . .to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption under section 501" Section 513 of the IRS Code

However, the nonprofits seek to make virtually all of their tour and travel activities "related" and the IRS is currently considering their request. The Business Coalition for Fair Competition has proposed "An Alternative Regulatory Approach to the Issue of Travel and Tour Promotion Activities" which makes very clear when a tour is tax-exempt and when its net income should be taxed. In contrast, the nonprofit proposal would bypass Congress by establishing a new "safe harbor" for nonprofits leaving IRS agents helpless in their pursuit of business income under the current law.

We respectfully request that the entire BCFC paper, along with the BCFC "Alternative Regulatory Approach" be printed in the hearing record because it contains excellent information for Members judging the merits of the nonprofit appeal. While the IRS may never resolve this matter, Congress may have to.

How the Executive Branch Favors Nonprofits in Contracting. The Army Corps of Engineers is currently having the water of the District of Columbia tested by the nonprofit Iowa Hygienic

Laboratory.[29] Why does the Corps rely on a nonprofit one thousand miles away when there are so many nearby for-profit labs with the capability to do the work?

When the White House issued an Executive Order recently, they included nonprofits as part of the definition of "small business."[30] Why pit for-profit and nonprofit organizations against each other?

Many Federal grant and contract programs specifically direct that funding go exclusively to nonprofits for various commercial services. The Executive Branch often denies itself full competition and capable commercial sources by awarding business to nonprofits. The Executive Branch excludes many small businesses from contracting policies by this practice.

What Congress Should Do

1. In any tax reform legislation, insist that all business income be taxed equally. The tax laws and regulations related to nonprofits are long overdue for reform. They are vague, replete with loopholes, leaving IRS agents with little specific guidance and no hope of winning most cases. All business income should be treated the same. The Federal government should stop giving a tax preference to a product or service which is produced by a nonprofit.

2. All statutes and regulations which deny small businesses opportunities to compete (by reserving the contract or grant exclusively to nonprofits) should be repealed.

3. The Congress should receive an annual report from the Department of Treasury declaring the revenue foregone due to

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[29] "D.C. to Continue Extra Chlorine in Water; Recent Tests Find No Bacteria," by D'Vera Cohn, The Washington Post, July 16, 1996 p. A 9.

[30] Executive Order 13005, May 21, 1996. "Qualified small business" means a small for-profit or not-for-profit trade or business. While this Executive Order is designed to help minority firms in low income areas, it does not help minority businesses by pitting them against nonprofit organizations. The minority delegates to the White House Conference on Small Business were just as against unfair competition from nonprofits and government as all other delegates.

the tax-exempt status of nonprofits. We do not propose to tax dues, meetings or contributions, but we do believe the Congress and the American public should know how much untaxed income is generated by the nonprofit community. While the Treasury reports to Congress all other categories of revenue foregone, the nonprofit category has never been revealed. The time has come.

4. Congress should prohibit any equipment or other assets obtained by nonprofits through Federal grants from being used for the production of commercial income. This will stop the practice of nonprofits obtaining high tech equipment through a Federal grant which they use do commercial non-Federal work. While the National Science Foundation has restricted the practice, the restriction is weakly enforced and is not governmentwide.

5. Congress should end the government's exclusive use of Federally Funded Research and Development Centers. As the Washington Post reported about these huge nonprofit enclaves:

"But in the past five years, dozens of reports by the General Accounting Office and congressional committees have begun uncovering billions of dollars in blunders traceable to DOE's lax supervision of the contractors who manage and operate its labs."[31]

While the waste of taxpayers' dollars is measured in the billions when it comes to the FFRDCs, the solution is not stricter regulation. The solution is in breaking up this cartel of exclusive non-competitors whose work comes directly from the agency without going through the contracting out requirements of OMB A-76. The solution includes competition in which small businesses may participate.

Small businesses are excluded except in the rare instance when an FFRDC subcontracts. Through this program the Executive Branch has created, nurtured and protected a network of

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[31] "Lax at the Lab: The Culture of Cost Overruns at America's Top Research Facilities," The Washington Post, March 13, 1994.

mammoth nonprofits (see Mitre above). The time to end this program has come.

To reach the Business Coalition for Fair Competition:

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Executive Director
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Annandale VA 22003
Phone 703 280 4622
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For-Profit Small Businesses	VS	Tax-Exempt Nonprofit Businesses
RV parks and campgrounds		Dozens of Federal/state agencies operate RV parks and campgrounds
Family-owned drug stores		Non-profit hospital pharmacies
Equipment rental companies		Universities, local governments and Federally funded 501 (C)(3) nonprofits
Helicopter rental firms		Government-owned helicopters used for commercial work
Building cleaning firms		Non-profits clean buildings
Private struck stop operators		State government run Interstate rest areas
Private security training firms		Community college onsite safety courses
Map makers/publishers		Government agencies survey/ draw/publish/distribute maps.
Laboratory testing		Federal, state and local government labs
Flag makers		Federally protected workshop
Ed software publishers		University and school district pub schemes
Private tree nurseries		University and govt forestry nurseries
Bus companies		City, county, regional bus operations
Consulting engineers		University and government in-house engineers
Family owned hotels & motels		University- and military- owned and managed
Vets/animal hospitals		Humane society, nonprofit veterinarians clinics and hospitals
Independent travel/tour		Higher ed, museum, YMCA travel businesses
AV/Video rentals		County convention centers, universities,
Health clubs		YMCAs, county rec centers, nonprofit hospitals
Medical equipment suppliers		Nonprofit hospital medical rentals
Private child care providers		Nonprofit and government childcare
Private golf courses		Government-owned municipal golf courses
Textile rental firms		Nonprofit hospital laundry rental services
Security firms		Local police security businesses
Hearing aid dealers		Nonprofit hospital hearing aid sales

Computer resellers	University resellers/bookstores
Fast food services	University fast food franchise facilities
Printing	Federal, state and local government printing
Flower retailers	Nonprofit flower/plant/tree sales

Testimony
House Small Business Committee
July 18, 1996

Robert P. Stack
President/CEO
Community Options, Inc.

Madame Chairman members of the committee, good day, my name is Robert Stack and I am the President and Chief Executive Officer of Community Options, Inc. Community Options is a non-profit corporation. Our mission is to develop housing and employment opportunities for persons with severe disabilities. I would like to thank the committee for allowing me the opportunity to share with you some of our successes in placing persons with severe multiple disabilities into regular jobs using the supported model. I believe that it is important to state that the agenda of Community Options is basically the same agenda of any of the people we serve, any of the family members, the members of this committee and anyone who is proud, as we all are to be Americans. Our agenda stated in one word is work. We fundamentally believe that everyone, regardless of their disability, who wants to work , can and should work. We believe that persons with disabilities have been excluded from the typical workplace through no fault of their own.

It is not because they become sick or infirmed more than workers who do not have disabilities. It is not because persons with disabilities do not have the drive or the desire to work, because they do. It is because of the simple fact that a synthetic environment, created with the most fundamental of good intentions was created to help protect persons with disabilities, in fact, prevent them from entering the work force. I, as a professional in the field, am guilty of developing this synthetic paradigm to "help" persons with disabilities. I did this for their well being when all it did was foster dependence, exploitation, alienation and segregation of persons with disabilities hidden behind what appeared to be professional acumen. Places like workshops, adult centers, occupational training centers and day programs have been old buzz words that dehumanize persons with disabilities.

While it is convenient for the professional to hold these services as hallowed programs that advance the progress of persons with disabilities, anyone with the ability to chart and observe progress with disabilities, will see that the majority of persons placed in these segregated versions of disability-based child labor sweat shops never leave. These folks are rarely trained to do anything other than remain in a workshop for the rest of their lives. They stay there and make an average of .25 per hour.

The persons generally stack and string and sort objects; they do meaningless work and they are stuck in an environment controlled by persons who have a vested interest in them staying there with no chance of getting out. They are relegated to work in an environment segregated from persons without disabilities. They are treated with sophomoric attitudes; they are treated as though they are little children. They are not afforded the same dignity that any American should have when he or she goes to work. They are told that they are happier if they are " with their

own kind".

This has been the mentality of the persons who operate those workshops, those training centers that in fact do no train, they stifle. This has been, up until about 10 years ago, ladies and gentlemen my mentality. It was wrong, and I am very sorry because I thought I was doing the right thing, just as the staff who run the workshops believe that they are doing the right thing but they, or I should say we were fundamentally wrong. The easiest way to prove this is to ask ourselves what is the point of a workshop of an adult training center? The answer is to teach people to work so that they can be in jobs. Okay, now let us ask how long have those workshops been around. The answer is over a decade.

The next question is how many persons with disabilities were unemployed a decade ago and then take note that statistically the number has increased, not decreased. Then when you factor in how much money the local, state and federal government have pumped into these workshops and it is evident to anyone that it is a lose/lose situation. It is tossing good money after money. It is status quo, ladies and gentlemen. What we have been doing is absolutely wrong. It has to stop right now and here, with you.

As with many of the domestic problems that you as law makers are confronted with I know there is no simple solution. Goodness, I have no idea what to do with the child labor sweat shops overseas, I have no idea about what to do to really reduce the deficit, or fix the welfare problem. However, I really do know how to make a significant difference in improving this horrific situation for persons with disabilities at a reduced cost to the taxpayers, with nothing but positive outcomes. Now I must say that you will hear others say that this may not work. My point is their methods did not work for two decades so all I ask is that you implement our suggestions and let me prove to you that this does in fact work.

I would also like to add that our suggestions are based on hands on experience in dealing with persons with the most severe disabilities. People who would tax the Medicaid budget, as well as raid state coffers and local taxes. People for example like Harold, and others that we serve just like him.

I first met Harold while he was living in an institution for person with developmental disabilities. Harold has lived in an institution for about 50 years of his life at a cost to taxpayers in excess of $80,000 per year. He did meaningless activities at the institution. When this institution was shut down because the physical plant was beyond repair, Harold was moved into a small home in the neighborhood. If it were business as usual for Harold he would have continued those same meaningless activates at a workshop that he had done in the institution. This is because he would be a prime candidate to be what I call "terminally" placed in a workshop for the rest of his life. You see, Harold was labeled as profoundly mentally retarded and he is also both totally blind and he is also totally deaf.

The only way that you can communicate with Harold is by using his hands and signing with and on his hands. Harold never had a job. He lived in an institution. He never knew anyone with the exception of the staff that helped him with his needs and others with disabilities. Through our

supported employment program, Harold was placed at the Hyatt in Princeton, New Jersey. We taught Harold, not in the workshop or at a "training facility", we taught him at the Hyatt. We taught Harold the same way most of us learn our job, on the job. To be glib, you learned the most about how to be lawmakers by passing legislation. I think it is safe to assume that no civics course, no college prep or passed bar exam come close to the mark of being a member of the legislative branch of government. The same logic applies to Harold. Harold learned how to fold towels and napkins in the laundry of the Hyatt. He not only learned his job, but he made friends. Now three years later, Harold has friends, takes the bus to work and is assisted by a co-worker that is subsidized $40 per week out of his $7.65 per hour salary. He has been commended as an excellent worker at the Hyatt and is a model for others with disabilities.

Harold is not an isolated example. Community Options has placed persons like Harold in Texas and Colorado, in New York and Pennsylvania, in Wisconsin and many cities throughout the United States. Incentives should be given to employers to hire persons with disabilities, not set aside contracts. These contracts promote segregation and dependency. They ostracize persons with disabilities from the work place and therefore from the community. Business leaders need to be educated about an untapped labor force that is in their community. Certainly, the education must begin at an early age.

Madame Chairman, I know that you have a history of creating services for persons with disabilities in special education. We need to show government, educational leaders and the business community that persons with disabilities can, in fact, work side by side persons without disabilities. People with disabilities are not looking for hand-outs, they are not looking for special treatment, they are like every other American - they are looking to find, keep and be challenged in a job. Persons with disabilities can work, and if this committee backs the elimination of set-aside contracts and creates incentives to businesses that foster integration not segregation, there will be a great deal more "Harolds" in the workplace.

I ask that this committee review the business at hand. I think that when you realize business as usual is essentially giving people with disabilities the business, you will promote change. I am asking for a fundamental shift in the way people with disabilities become members of the workforce. I will assist this committee, or anyone you would like me to work with, to make the "Harolds" happen on a larger scale. We need to move from a "train and place" model to a "place and train" model. A model in which the person is trained on the job; not a model where the person is terminally trained and never placed in the job. This committee can make a significant difference in the quality of life for so many people. Let's get out of the basket weaving mentality of the 20th Century and into a mind frame focused on meaningful work with career vision so that people with disabilities can be recognized as an important and viable workforce for the 21st Century.

Thank you.

International Hearing Society

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Written Statement on Behalf of the
International Hearing Society

House Small Business Committee
Hearing on

Unfair Government-Supported Competition
with Small Business:

Recommendations from the
1995 White House Conference on Small Business

July 18, 1996

Submitted by Robin L. Holm
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1996 IHS Convention
DISCOVER THE MAGIC!
Orlando, Florida
August 28 – September 1, 1996

"Small businesses' contribution to job creation is no longer our economy's best kept secret. Small business is deservedly recognized as "the engine that drives the economy." It was small businesses, after all, that led the country out of the most recent recession, creating virtually all the new jobs since 1987."

Report for the President and Congress
by the White House Conference on
Small Business Commission

September 1995

"[Nonprofits] are ... pretty good at making money -- despite their tax-exempt status ... by going commercial with business ventures that keep growing and growing -- at taxpayers' expense."

USA Today
June 20, 1995

"The nonprofits' tax-exempt status helps them undercut competitors who pay taxes. And when those competitors lose business, taxpayers pay the price."

USA Today
June 20, 1995

Written Statement on Behalf of the International Hearing Society

House Small Business Committee Hearing on

Unfair Government-Supported Competition with Small Business:

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July 18, 1996

Submitted by Robin L. Holm
Executive Director

I. Introduction

The International Hearing Society ("IHS") represents the vast majority of traditional hearing aid specialists/dispensers (hearing aid specialists) in the United States. IHS members are the nation's most experienced health care providers in the testing, selection, and fitting of hearing aids. IHS members typically are small business men and women strategically located and accessible to the hearing-impaired public throughout the United States. Hearing aid specialists are located in rural areas and small towns, as well as major metropolitan centers. A large number of IHS members are second and third generation hearing aid specialists, whose small businesses are generous and significant contributing forces in their communities.

IHS appreciates the opportunity to submit its views on unfair government-supported competition with small business. IHS presented testimony to Congress on this issue nearly a decade ago. Since that time, hearing aid specialists and countless other small business men and women in a wide variety of industries across the country have experienced increased competition from the tax-exempt sector.

In our case, tax-exempt institutions such as hospitals, clinics, and universities continue to erode the client base of taxpaying hearing aid specialists by selling or facilitating the sale of hearing aids to the general public, often at below-market prices. This undermines the free market and will eventually drive taxpaying entities out of business.

IHS urges Congress to swiftly take action to level the competitive playing field so that tax-exempt institutions no longer may capitalize on their tax-exempt status to unfairly compete with taxpaying businesses.

II. Advantages Enjoyed by the Tax-Exempt Sector over the Tax-Paying Sector

Tax-exempt entities enjoy significant competitive advantages over taxpaying businesses including:

- exemption from federal taxes;
- exemption from state taxes;
- exemption from local taxes;
- exemption from unemployment compensation coverage;
- greatly reduced postal rates;
- the halo effect, *i.e.*, perception as a "goodwill" organization that heals the sick or provides health care to the needy (this can soften the public's perception of slick marketing strategies);
- access to reduced cost mailing lists and public service announcements;
- use of donated equipment and facilities;
- availability of volunteers;
- "captive" referrals (where clients receiving one service from a tax-exempt firm are referred to in-house operations for other services);
- the ability to receive tax deductible donations of services, goods, contributions, and incurred expenses (consider the use of audiology testing equipment provided at government expense); and
- development of layered corporate structures where the tax-exempt entity is treated as an affiliate or subordinate, while operating at one location.

While tax-exempt entities operate with the full benefits of tax-exempt status described above, they may simultaneously engage in advertising and sales techniques typically associated with commercial enterprises, such as advertising in the yellow pages. In addition, they may establish off-site clinics to attract the general public. IHS urges Congress to step up monitoring and enforcement to ensure that the tax-exempt activities of tax-exempt institutions are appropriate to those organizations' functions and, if not, that such activities are taxed appropriately.

III. IHS Urges Adoption of Recommendation 14 of the 1995 White House Conference on Small Business

Government-assisted competition with tax paying small business enterprises has enjoyed robust growth over the past fifteen years despite the repeated adoption by the White House Conference on Small Business (in 1980, 1986, and most recently in 1995) of recommendations to address the issue. The most recent recommendation called for Congress to "enact legislation that would prohibit ... tax-exempt and antitrust-exempt organizations from engaging in commercial activities in direct competition with small businesses." (*See Foundation for a New Century: A Report to the President and Congress, White House Conference on Small Business*, September 1995 at p. 26.) Accordingly, IHS joins with the White House Conference on Small Business and the Business Coalition for Fair Competition in asking Congress to adopt such legislation.

IV. Relief from Tax-Exempt Competition is Needed Today More than Ever Given the Rapidly Changing Health Care Marketplace

Further compounding the effect of competition from the tax-exempt sector is the growth of managed care. The advent of managed care has further squeezed the hearing health market because many HMOs restrict provider panels, which effectively precludes any provider not on an HMO panel from that segment of the hearing-impaired market participating in HMOs. Because seven of ten employed Americans now participate in managed care, the dramatic growth of managed care has further magnified the effect of competition from tax-exempt entities. Accordingly, relief for the small business hearing aid specialist from tax-exempt competition is more important today than nine years ago.

V. The Negative Effects of Unfair Government-Assisted Competition Are Felt Not Just by Small Business but by Communities Across the Nation

The negative effects of undue tax-exempt competition are felt not just by small business but by communities across the nation whose tax base shrinks when unfair tax-exempt competition forces taxpaying entities out of business. As a result, taxpayers must both make up for those lost taxes and pay the resulting unemployment benefits.

IHS urges Congress to level the playing field. This will increase tax bases in communities affected by undue government-assisted competition and ensure that small business men and women such as IHS members are shielded from unfair competition from tax-exempt entities.

VI. Tax-Paying Hearing Aid Dispensers are Sorely in Need of Relief from Unfair Government-Assisted Competition

The commercial promotion of hearing aid sales by tax-exempt entities is thriving, despite the recognition that undue competition from the tax-exempt sector with tax-paying businesses is an ever increasing concern. (*See* Attachment, article from July 24, 1996 *Washington Post*.) Because the problem of unfair competition is national in scope but local in impact, the impact on affected communities can be enormous. Our members across the country regularly share with us instances of the commercial promotion of hearing aid sales by tax-exempt clinics, hospitals, and educational institutions and the resultant impact on tax-paying hearing aid providers.

Across the country, tax-exempt hospitals and universities establish hearing centers -- not merely to provide more comprehensive or more convenient services to their current patients or to provide training opportunities for their students -- but also to penetrate new client populations and markets traditionally served by hearing aid specialists and that clearly are commercial in nature. The tax-exempt hearing centers compete directly with taxpaying hearing aid dispensers by serving a significant portion of the general public and by often pricing their services and products at below market rates.

VII. Conclusion

IHS urges swift Congressional action to address the inequitable government-supplied advantages enjoyed by tax-exempt organizations at the direct expense of the taxpaying small business sector, including hearing aid specialists.

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THE WASHINGTON POST WEDNESDAY, JULY 24, 1996

Cancer Society in an Ethics Dispute

Marketers of Patient Apparel Say Charity Is Hurting Their Business

By Amy Goldstein
Washington Post Staff Writer

A new mail-order catalogue has arrived in the mailboxes of 120,000 U.S. women, its glossy pages filled with ads for chic hats, sleek turbans, satin nightgowns and a video on how to tie scarves.

It resembles many catalogues created in recent years as the shop-at-home industry has flourished, except for the small logo on the cover: American Cancer Society.

The cancer society has developed "Tender Loving Care" ("*tlc*") to provide products and dignity to women who have lost their breasts to cancer or their hair to chemotherapy, allowing them to shop for highly personal products in private.

But since the catalogue first appeared last year, "*tlc*" also has fostered a dispute over the border between entrepreneurship and charity.

Although many women say they like the catalogue, the venture has infuriated the owners of cottage industries that make turbans, hats and other apparel for cancer patients. Many are women who went into business because of their own ordeals with cancer. They feel betrayed that a charity they have supported is competing with them, and they are indignant that a few items in the catalogue are lower-priced knockoffs of their own designs.

Some state and local cancer society leaders are uneasy, too. They have complained to the society's national headquarters that some items should not be sold by mail order. They say some stores and manufacturers have stopped donating goods to their chapters. More fundamentally, they believe the catalogue violates one of the organization's basic tenets.

"We have always used the disclaimer in everything we do; we don't endorse specific products. So when did the rules change?" said Cara McElhaney, director of patient services for the Houston chapter.

The catalogue and the controversy it has stirred reflect the extent to which a niche market of commercial goods has grown up around cancer, particularly breast cancer, as the disease has become more common.

See CANCER, A29, Col. 1

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CANCER, From A1

The lifetime risk that a woman will get breast cancer has risen from one in 13 in 1970 to one in nine today.

Such growing prevalence has led to a new openness in dealing with a disease that used to be stigmatized. As a result, more information and products, ranging from turbans to teddy bears, are being marketed to help cope with the debilitating physical and psychological effects of cancer and its treatment.

"You look in the mirror and you want to throw up, because you have no eyebrows, no eyelashes, no hair, no color, no breast," said Verley Platt, who started a hat manufacturing business out of her house in Philadelphia after her diagnosis a decade ago. "If you can't deal with the fact you might die, you can at least deal with the fact you want to look good."

Cancer society officials remain enthusiastic about the project. Although it still is experimental, they have decided to prepare a second issue, with an expanded printing of 200,000 copies, due out after Labor Day. "Our mission is to . . . fill a need that is out there for women who are suffering and fighting this disease," said Cynthia Currence, national vice president for marketing.

Kay Gravette, however, thinks the cancer society's methods are unfair. Gravette, 43, a former dental hygienist who lives outside Salt Lake City, was diagnosed as having breast cancer and had a mastectomy in 1990. During nine months of chemotherapy and radiation treatments, months when her head was bald and the wigs she tried were hot and scratchy, she started sewing turbans using the 4-H Club skills she had learned in fourth grade.

Three years later, she founded Hats with Heart, a company that employs five seamstresses and sells its wares to mastectomy boutiques, wig shops and medical supply stores. It has lost money every year.

She first heard of the cancer society's venture early in 1995, when she got a telephone call from a woman named Lana Rosenfeld in New York. Rosenfeld said she wanted to consider Hats with Heart products for a new catalogue for cancer patients. "We shipped her our whole line," Gravette said.

Several months ago, she was astounded to discover that two designs identical to hers—for a turban and a liner for hats—were in the new catalogue, in different fabrics and at a lower price.

Said Gravette, a longtime cancer society volunteer who now is being treated with chemotherapy for a recurrence of her illness: "I just don't want to believe the American Cancer Society would go in and rip off our ideas. Yet I've got a check here with their name on it for the orders they ripped off."

Rosenfeld is the main force behind *"tlc."* Though the daughter of the founder of Hanover Direct, a large mail-order company, she had not worked in the industry until her husband mentioned he had brainstormed about a catalogue for cancer patients with a friend who'd had breast cancer. She loved the idea, believing it could offer sick women a way to shop from home for products at prices lower than those in hospital shops and specialty boutiques.

Rosenfeld persuaded the American Cancer Society Foundation to cover the catalogue's costs, about $200,000 so far. It would intersperse items for sale with information useful to cancer patients; next to a lacy nightgown and bed jacket is a frank discussion of sexuality after cancer. And she researched the products available for such patients and decided what to include.

She works as an unpaid volunteer. Hanover Direct, of which her husband was president until earlier this year,

BY GARY M. McKELLER FOR THE WASHINGTON POST

has donated some services but is paid by the cancer society for handling the telephone orders.

The first issue of *"tlc"* was distributed to women in five states and New York City. Maryland, Virginia and the District were not included, but some women in the Washington area have seen the 16-page catalogue because it also was mailed to certain doctors and nurses nationwide and because some local women saw it mentioned in magazines and ordered it.

Customers have placed 4,700 orders. Eight percent of the $215,000 worth of orders has been returned—a relatively low rate, according to cancer society figures.

Michael J. Mitchell, executive director of the cancer society foundation, said that *"tlc"* is designed to break even. If it began to generate revenue, he said, the foundation would expand the information pages.

The catalogue is proving popular, according to feedback that the society has received. "It allows you to shop for things you don't have at any store," said a 56-year-old breast cancer survivor who lives in St. Mary's County, remote from the speciality boutiques in larger communities.

She ordered a bra with a special pocket inside for a breast form. Until it arrived, she had been pinning her foam form into a regular bra, a method that caused pinpricks. "I've been making do for eight years," said the woman, who asked not to be identified.

Barbara Coyne, of Arnold, ordered breast forms to slip inside her bathing suit. "Everything in that catalogue is very well priced, and that is great," she said.

Manufacturers said that they do not mind competition but that they resent the cancer society's access to mailing lists and donated services unavailable to them. "It is an issue of the American Cancer Society using its vast reservoir of goodwill and trust to sell products," said

BY ERICA BERGER FOR THE WASHINGTON POST

At odds over the marketing of a mail-order catalogue, above foreground, called "tic" are Kay Gravette, at left with her Hats with Heart designs, and Lana Rosenfeld, who gained American Cancer Society funding for the catalogue.

Peggy Childs, who owns Designs for Comfort in suburban Chicago.

Childs is particularly upset in light of a stern letter she received a few years ago from the society's national headquarters, directing her to delete from her company brochure a statement that her products were "approved" by a society program that helps newly diagnosed women.

In small print on a back page, *"tic"* says that the cancer society has not tested or endorsed its contents. But Childs said that, with the society's logo on the cover and a letter from its president on the first page, "if that's not real endorsement, it is certainly implied endorsement."

Several state and local chapters have criticized the catalogue for including prostheses, silicone breast forms that many women wear after mastectomies. They said the society has long taught women to get a personal fitting for a prosthesis to avoid back and shoulder pain.

Mitchell, of the cancer society foundation, said that, in response to such complaints, there will be no prostheses in the next issue. However, Rosenfeld said they were being omitted because two large manufacturers stopped providing prostheses after complaints by retailers that the cancer society was undercutting their prices.

Manufacturers also contend that some hats in the catalogue are improperly designed for women who are bald from chemotherapy, and that the hats' appearance in the catalogue is misleading because the models have hair. Rosenfeld, who hired the models, said: "We never said the models had breast cancer and hair loss. Women like to look at somebody who is attractive. It is saying to women, we see you as pretty, too."

Manufacturers are most upset, though, that the catalogue sells products nearly identical to ones that Rosenfeld borrowed from them.

Mary Trentham said Rosenfeld had gotten factories to make less expensive versions of a turban and sleep cap she designed for Jazz Up!, the small company she started in her garage in Houston eight years ago after a friend had a brain tumor.

"I was furious. . . . I felt she used the American Cancer Society front to get our products and knock them off," Trentham said. "I don't think it is against the law, but I think it is kind of mean, unethical."

Rosenfeld said the catalogue items are "sort of similar, I have to admit," to products designed by Trentham and Gravette, the Utah manufacturer. "I ordered samples to see what is out there," Rosenfeld said. "That is the name of the game in fashion. You copy, unless there is a patent, and [they] don't have any patent."

"All is fair in love, war and retailing," said Alan Millstein, a New York fashion consultant. "If a nonprofit wants to get into this business to provide a national catalogue, that is absolutely spectacular."

The cancer society says many owners of small companies catering to cancer patients, now irate about the catalogue, have had a complicated relationship with the society. They have donated their time and products, and they benefit by meeting potential customers. "Some of these vendors have become involved with us because they get access to patients," Currence said. "They need to step back and say, has their involvement been a conflict of interest?"

Platt, of Philadelphia, said it is the cancer society whose aims are in conflict. "You can't be an advocate for . . . cancer patients, then market to this group, using your prestige to sell a product. There is a certain amount of trust the American Cancer Society has your interests at stake."

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August 5, 1996

The Honorable Jan Meyers
Chairman
House Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

Dear Rep. Meyers:

This letter is submitted on behalf of the North American retail Dealers Association (NARDA) in connection with hearings recently held by the Committee on the subject of competition between small businesses and government and nonprofit organizations.

By way of background, NARDA's membership is comprised of more than 3,200 businesses which sell and service major home appliances, consumer electronic products, furniture and computers. These businesses are use to formidable competition: mass merchandisers and discount retailers make business life difficult for NARDA members each day of the week.

However, these large competitors follow "rules" applicable to all private sector retailers, that is, they collect state and local sales taxes on customer purchases, they abide by federal antitrust and similar laws, and they pay, in one way or another, for the land on which their stores sit.

However, in many markets NARDA members face a competitor who is not obligated to abide by these "rules." That competitor is the federal government's military exchange system, a $10-billion retail giant with the capability to unfairly crush any small retail competitor which gets in its way. Consider these facts:

- Under federal law known as the Buck Act, military exchanges are not required to collect state and local sales taxes on products they sell. This amounts to a 5%-plus advantage over NARDA members and other private sector retailers, who must collect the taxes. Often, in low-margin products like computers and consumer electronics products, this difference results in lost sales.

- Military exchanges do not pay for the land on which their stores sit. While the cost of constructing exchanges does come out of profits generated by sales, land is donated by military bases.

▸ Military exchanges are not subject to federal antitrust and other laws. For instance, the Robinson-Patman Act, a statute which is quite familiar to this Committee, protects small business by requiring suppliers to make pricing and other terms of sale available equally to all similarly-situated competitors. However, there is one glaring exception to this Act, which has been described as the "Magna Carta of Small Business": pricing "deals" not offered to small business can be made available to government entities such as military exchanges. Thus, exchanges are able to use their enormous buying "clout" to extract prices from suppliers that are simply not offered to small businesses.

By way of illustration, one NARDA member located near a major Georgia military installation reported earlier this year that the military exchange was selling a satellite broadcast reception disk for some $50 less than he was obligated to sell the disk for at retail under the terms of the manufacturer's cooperative advertising program. When the fact that the exchange was not obligated to collect Georgia state sales tax, the difference came to more than 10% of his retail price!

Military exchanges also enjoy another advantage not available to their small business competitors, the ability to borrow money at substantially below-market rates. Exchange representatives told the House Natural Security Committee's Morale, Welfare and Recreation Panel earlier this year that they were able to borrow funds at a mere 3% interest.

Notwithstanding these advantages, military exchanges want more. During last year's consideration of the National Defense Authorization Act for Fiscal Year 1996, the Senate Armed Services Committee approved a provision which would have removed all current restrictions on products which exchanges may sell in the continental United States. This provision, offered without a public hearing or other public consideration, would have been devastating to small business, and NARDA worked closely with other interested organizations in a successful to have the provision dropped in a Senate-House conference. For your information, Rep. Meyers, I have enclosed a list of those organizations who joined with NARDA in opposing this provision. This list will let you know that it is not just appliance and consumer electronics retailers who are adversely affected by this unfair competition from military exchanges.

What NARDA seeks, Rep. Meyers, is a review by either this Committee or the House National Security Committee of the competitive threat posed to small business by the operations of the military exchange system. Such a review should, in NARDA's view, lead to consideration of Buck Act modification, among other things.

In conclusion, NARDA would appreciate inclusion of this letter in the Committee's hearing record, and consideration of these views as the Committee's report on government and nonprofit competition with small business is prepared.

Sincerely,

James M. Goldberg

Enclosure

ORGANIZATIONS SUPPORTING DELETION OF SECTION 372 AND SECTIONS 631-633 OF SENATE VERSION OF NATIONAL DEFENSE AUTHORIZATION ACT

Business Coalition for Fair Competition
Business Technology Association
Circuit City Stores, Inc.
Citizens Against Government Waste
Federation of Tax Administrators
Food Marketing Institute
International Mass Retail Association
Jewelers of America
National Association of Beverage Retailers
National Association of Chain Drug Stores
National Association of Convenience Stores
National Association of Retail Druggists
National Decorating Products Association
National Federation of Independent Business
National Grocers Association
National Home Furnishings Association
National Retail Hardware Association
National Taxpayers Union
National Tire Dealers and Retreaders Association
North American Retail Dealers Association
Small Business Legislative Council
Tandy Corp.
World Floorcovering Association

MITRE

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President
and Chief Executive Officer
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July 29, 1996

The Honorable Jan Meyers
Chairman
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515-6315

Dear Madam Chairman:

During your July 18 hearing dealing with unfair government competition with small business, you heard testimony from Thomas J. Scanlon which contained a factual error regarding the MITRE Corporation.

Mr. Scanlon referred to the January, 1996 division of the MITRE Corporation into two companies through the creation of a new not-for-profit company called Mitretek Systems, Inc. As Mr. Scanlon correctly said, MITRE is now focusing its work on its two Federally Funded Research and Development Centers (FFRDCs) serving the Department of Defense and the Federal Aviation Administration.

However, Mr. Scanlon went on to say that "Mitretek Systems will manage MITRE's sales to federal, state, and local government." This incorrectly implies a continuing connection between MITRE and Mitretek Systems. In fact, Mitretek Systems has taken over the work that MITRE previously performed for federal agencies outside the scope of its FFRDCs, as well as for state and local governments. MITRE and Mitretek are separate companies with no overlap of members of its Boards, its officers, or employees. Mitretek is not an affiliate or agent for MITRE.

I would appreciate it if you would add this letter to the record of the hearing.

Sincerely,

V.A. DeMarines

cc: Congressman Martin T. Meehan
Congressman Peter G. Torkildsen

The MITRE Corporation
202 Burlington Road
Bedford, Massachusetts 01730-1420

ACIL

July 16, 1996

The Honorable Jan Meyers
Chairman, House Small Business Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Madam Chairman:

We request these remarks to be included in the record of testimony for the July 16, 1996 hearing on unfair government competition.

We commend you for holding these hearings. Unfair competition from federal facilities is having a profound effect on the commercial laboratory testing industry. Government laboratories are adding capability -- investing in facilities, instrumentation and personnel -- to perform routine testing and analyses already available in the private sector. Other federal laboratories are using excess capacity to carry out routine testing for other federal, state or local entities for a fee. Finally, some government laboratories are entering commercial markets, bidding as subcontractors on private-sector contracts.

ACIL is a national trade association representing the commercial testing laboratory industry. Our members provide scientific and engineering testing services for construction materials, pharmaceuticals, food, product safety, and the environment. Our members also routinely work for federal and state agencies. The vast majority of testing laboratories (approximately 80%) are small businesses with annual revenues of $5 million and under.

We recognize the need for the federal laboratories to maintain a modest, core analytical capacity for essential functions such as high-level research, emergency response and highly-radioactive analyses. It's not the maintenance of that capability with which we take issue. We object to the federal laboratories competeing withthe private sector. For example:

- The federal laboratories, primarily Energy Department (DOE) and Defense Department (DOD) and National Aeronautic and Space Administration (NASA) facilities, are moving into the testing business, even though it costs more and is less efficient for them to do so. For example, more than 50 percent of the Energy Department samples that could be performed more cost-effectively by the private sector are instead performed in-house. In some cases, the private sector is the contractor of last resort, receiving work from a particular site only after the site has run out of internal capacity. (re: GAO Report # GAORCED-95-118, *Centralized Contracting of Laboratory Analysis Would Produce Budgetary Savings*; DOE Inspector General Report # CR-B-95-01, *Audit of Effectiveness and Efficiency of the Rocky Flats Analytical Services Program*)

- In other instances, Defense Department laboratories are capturing work traditionally procured from the private sector. Using interagency support services agreements, federal laboratories are performing testing for other government entities for a fee. In doing so, they are bypassing the procurement process and denying the private sector an opportunity to compete.

- More disconcerting are the federal facilities that bid on private-sector contracts. For example, two

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> Defense Department laboratories are currently bidding against commercial firms for routine environmental simulation testing for a large manufacturer. This type of testing is not unique in nature and does not require the special research capabilities for which DOD laboratories are designated.

These occurrences of direct competition with the private sector are widespread. For example, the Aberdeen facility routinely tests electromagnetic automotive components for a major car manufacturer. The Indian Head and China Lake facilities have utilized unrealistic cost and bidding practices to win environmental simulation testing contracts.

The authority that the government laboratories have to compete directly against the private sector is dubious. Various federal departments, however, are trying to legally justify their competition with the private sector. Recently, a Memorandum for Distribution by the Assistant Secretary of the Navy was sent to the Navy laboratories. This memo states that under Title 10, Section 2553 of the United States Code, there are provisions in place that allow the DOD laboratories "to sell to non-Defense customers." However, Title 10, Section 2553 states that the DOD can sell those services "that are not available from any commercial United States source" (See Attachment A, *Navy Department Memorandum for Distribution*, and Attachment B, *Title 10, United States Code, Section 2553*). Clearly, this law was not intended as a mechanism to compete with the private sector on services which are professionally available. It is intended to allow the development of sophisticated technologies to further military and economic competitiveness.

Congruent with our interpretation is a recent Department of Justice ruling against a federal laboratory (see attachment C, *Battelle Agrees to Pay U.S. $330,000 for Misusing DOE Equipment*). The operators of the Pacific Northwest Laboratory were fined $330,000 by the federal government for performing unauthorized services. ACIL is encouraged to see that the government, given an opportunity, will enforce its policies regarding unfair government competition. However, it's distressing that this action would not have been taken had the suit not been brought by a disgruntled Battelle employee on behalf of the government.

Another justification for internalizing this work is based on an assumption that government is the more cost-effective provider. However, these assumptions are often based upon ambiguous cost comparisons. The cost comparisons being used to justify competition with the private sector are not the best way to procure analytical services because they fail to take quality into consideration. This is a major shortcoming of OMB Circular A-76, the federal policy that determines whether a service can be performed more cost-effectively if it is outsourced. Unlike the private sector, government agencies do not fully allocate overhead to determine true operating costs. This fundamental difference in overhead allocation results in an apples-to-oranges cost comparison, and should not be used to determine whether a service is outsourced. Nor should it be used as a cost baseline to compete against private-sector firms for commercial contracts.

For example, if the DOD saves 31% (a figure submitted to Congress by Deputy Secretary of Defense John P. White) when non-core defense tasks are privatized, how can DOD laboratories continue to assert their cost efficiencies? Such facts call into suspicion the costing techniques used by the federal laboratories. It also underscores the weaknesses in the current system for utilizing the private sector. Yet, DOD cost comparison policies provide DOD managers the excuse to internalize laboratory testing as well as bid on commercial contracts.

Even if the government is the lowest unit cost provider of a particular service, does it also mean it is the best

provider of that service? Quality and timeliness are not part of a cost-based selection process. No doubt, the timeless adage "you get what you pay for" applies. In the end, basing procurement of professional services on cost excuses the government from a realistic assessment of performance capability and quality.

The need to ensure quality outweighs the initial cost savings achieved through the lowest bid. For example, in most environmental contracts analytical services usually comprise between 5-10% of the total contract value. However, all environmental decisions are made based upon the laboratory data. The added cost of ensuring that the data is reliable is minimal compared to rework costs and other headaches if the data is of unknown quality. Since commercial laboratories are accredited to perform various types of analyses, they can demonstrate the proficiency to produce data of know quality.

The endless cost comparisons and justifications are only diverting resources away from core government functions. With shrinking budgets, it is illogical to continue subsidizing the federal laboratories so they can compete against tax-paying firms. Reliance on the private sector for specialized services, such as laboratory testing, eradicates the continued and costly process of finding new missions for obsolete federal entities. Using commercial laboratories ensures that the government is receiving quality and cost-efficient analytical services -- allowing the government agencies to focus on it core mission of servicing the public.

It has never has been the intent of Congress to allow the federal government to compete with the private sector. Since its inception, the government has dedicated itself to protecting and promoting the free enterprise system -- one of the pillars of our democracy. Instead, subsidizing government agencies to compete in the commercial marketplace is socialism.

However, there is no police force to protect the private sector from the government employees engaged in entrepreneurial activities. The Congress, which appropropriates and authorizes these agencies, is the only mechanism that can check this activity. Therefore, we ask Congress to implement strong and enforceable legislation that discourages unfair government competition. The policy should not hamper the government's ability to perform key functions for public health and safety, nor should the government be stopped from performing basic science and high technology functions that will further the economic competitiveness of the United States. However, the policy should not allow the federal agencies to indiscriminately provide services that are readily available from the commercial sector.

We also ask that the federal government also stop the use of interagency support agreements. Such agreements are not in the taxpayers best interest because they avoid the competitive bidding process and does not provide the private sector a fair opportunity.

Thank you for allowing us to submit these comments.

Sincerely,

Anthony P. Pagliaro
Director, Government Relations

Attachment A

964126001

THE ASSISTANT SECRETARY OF THE NAVY
(Research, Development and Acquisition)
WASHINGTON, D.C. 20350-1000

JUN 13 1996

MEMORANDUM FOR DISTRIBUTION

Subj: NAVY ACTIVITIES PROVIDING GOODS OR SERVICES TO NON-DOD PARTIES

Ref: (a) ASN(RD&A) memo of 15 Dec 95, w/encls; same subject

Encl: (1) USD(A&T) memo of 1 Apr 96; subj: Sale of Articles and Services of Working Capital Industrial Facilities to Persons Outside the DoD

By reference (a), I provided Department of Defense (DoD) and Navy implementation procedures for a new statute, 10 U.S.C. 2553 (Section 2553), authorizing sales to private parties by DoD working capital funded industrial facilities. This memorandum is to inform you of a change in DoD implementation policy for this statute and to clarify Navy policy.

Until issuance of enclosure (1), DoD had implemented Section 2553 for defense depot-level maintenance activities only. In November 1995, my office requested that the Under Secretary of Defense (Acquisition and Technology) (USD(A&T)) extend implementation of Section 2553 to all working capital funded industrial activities. Wider implementation would allow Navy working capital funded industrial activities other than depot-level maintenance activities to also benefit from use of Section 2553 authority. USD(A&T) recently granted our request by enclosure (1).

Accordingly, all Navy working capital funded industrial activities now are eligible to seek approval to perform work for non-DoD customers pursuant to Section 2553 and the reference (a) procedures.

It is my understanding that, in enacting Section 2553, Congress clearly intended to broaden the authority of defense activities to sell to non-Defense customers. Congress recognized the benefits of this authority, including enhanced commercialization of dual-use technologies, promotion of economic growth and creation of jobs, increased use of defense assets to lower DoD operating costs, and increased access of the private

sector to defense-unique capabilities. Secretary Dalton and I fully support these goals.

I realize that, while not so intended, Section 2553 in certain respects has the effect of being more restrictive than prior Navy Regulations (Article 0835 of the U.S. Navy Regulations of 1990) used by some Navy activities in the past as authority to perform work for non-DoD customers. Nevertheless, I want to make clear that my policy is to maximize the ability of Navy activities, within existing law, to perform work for non-DoD customers in order to achieve the benefits Congress intended. I encourage Navy activities to seek approval to use the new Section 2553 authority to the broadest extent possible, or to pursue work for non-DoD customers under other statutes that may apply in specific situations. Addressees should ensure maximum dissemination of this policy memorandum.

My point-of-contact for further information or assistance is Katharine Carney, Office of the Assistant General Counsel (Research, Development and Acquisition), who can be reached at 703-697-1642/DSN 224-1642 (voice) or 703-695-3787 (FAX).

John W. Douglass

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Attachment B

§ 2553. Articles and services of industrial facilities: sale to persons outside the Department of Defense

(a) AUTHORITY TO SELL OUTSIDE DOD.—(1) The Secretary of Defense may sell in accordance with this section to a person outside the Department of Defense articles and services referred to in paragraph (2) that are not available from any United States commercial source.

(2)(A) Except as provided in subparagraph (B), articles and services referred to in paragraph (1) are articles and services that

are manufactured or performed by any working-capital funded industrial facility of the armed forces.

(B) The authority in this section does not apply to sales of articles and services by a working-capital funded Army industrial facility (including a Department of the Army arsenal) that manufactures large caliber cannons, gun mounts, recoil mechanisms, ammunition, munitions, or components thereof, which are governed by regulations required by section 4543 of this title.

(b) DESIGNATION OF PARTICIPATING INDUSTRIAL FACILITIES.—The Secretary may designate facilities referred to in subsection (a) as the facilities from which articles and services manufactured or performed by such facilities may be sold under this section.

(c) CONDITIONS FOR SALES.—A sale of articles or services may be made under this section only if—

(1) the Secretary of Defense determines that the articles or services are not available from a commercial source in the United States;

(2) the purchaser agrees to hold harmless and indemnify the United States, except in any case of willful misconduct or gross negligence, from any claim for damages or injury to any person or property arising out of the articles or services;

(3) the articles or services can be substantially manufactured or performed by the industrial facility concerned with only incidental subcontracting;

(4) it is in the public interest to manufacture the articles or perform the services;

(5) the Secretary determines that the sale of the articles or services will not interfere with the military mission of the industrial facility concerned; and

(6) the sale of the goods and services is made on the basis that it will not interfere with performance of work by the industrial facility concerned for the Department of Defense.

(d) METHODS OF SALE.—(1) The Secretary shall permit a purchaser of articles or services under this section to use advance incremental funding to pay for the articles or services.

(2) In the sale of articles and services under this section, the Secretary shall—

(A) charge the purchaser, at a minimum, the variable costs, capital improvement costs, and equipment depreciation costs that are associated with the articles or services sold;

(B) enter into a firm, fixed-price contract or, if agreed by the purchaser, a cost reimbursement contract for the sale; and

(C) develop and maintain (from sources other than appropriated funds) working capital to be available for paying design costs, planning costs, procurement costs, and other costs associated with the articles or services sold.

(e) DEPOSIT OF PROCEEDS.—Proceeds from sales of articles and services under this section shall be credited to the funds, including working capital funds and operation and maintenance funds, incurring the costs of manufacture or performance.

(f) RELATIONSHIP TO ARMS EXPORT CONTROL ACT.—Nothing in this section shall be construed to affect the application of the export controls provided for in section 38 of the Arms Export Control

Act (22 U.S.C. 2778) to items which incorporate or are produced through the use of an article sold under this section.

(g) DEFINITIONS.—In this section:

(1) The term "advance incremental funding", with respect to a sale of articles or services, means a series of partial payments for the articles or services that includes—

(A) one or more partial payments before the commencement of work or the incurring of costs in connection with the manufacture of the articles or the performance of the services, as the case may be; and

(B) subsequent progress payments that result in full payment being completed as the required work is being completed.

(2) The term "variable costs", with respect to sales of articles or services, means the costs that are expected to fluctuate directly with the volume of sales and—

(A) in the case of articles, the volume of production necessary to satisfy the sales orders; or

(B) in the case of services, the extent of the services sold.

(Added P.L. 103-337, § 339(a)(1), Oct. 5, 1994, 108 Stat. 2718.)

Attachment C

U.S. Department of Justice

FOR IMMEDIATE RELEASE
MONDAY, JUNE 3, 1996

CIV
(202) 616-2765
TDD (202) 514-1888

BATTELLE AGREES TO PAY U.S. $330,000 FOR MISUSING DOE EQUIPMENT

WASHINGTON, D.C. -- The Department of Justice announced today that Battelle Memorial Institute has agreed to pay the United States $330,000 to settle allegations it used government-owned equipment to service commercial customers in violation of a federal contract.

The payment settles claims brought in a qui tam lawsuit by Jagdish C. Laul, a former Battelle scientist at the Department of Energy's Pacific Northwest Laboratory. Battelle, a not-for-profit Ohio corporation, operates the laboratory on behalf of DOE under an approximately $500 million annual contract.

DOE, which owns most of the property and equipment at PNL, allows Battelle to use the equipment under certain circumstances for non-government customers. The lawsuit alleged that Battelle knowingly used DOE equipment for commercial purposes without informing DOE and failed to pay DOE for the use of the equipment as required under its operating contract.

After the DOE Office of the Inspector General began an investigation in 1992, Battelle reimbursed the government $110,000 for unauthorized use of certain spectrometry equipment

from 1988 through 1992. Spectrometers are used for chemical and radiation analysis.

Laul brought the suit under the qui tam provisions of the False Claims Act, which allows private individuals to sue on behalf of the government and share in any recovery obtained as a result of their lawsuit. Under the settlement agreement, Laul will receive $60,800 for bringing the action.

The False Claims Act provides for the recovery of treble damages suffered by the government and penalties for each false claim submitted.

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96-250

International Association of Environmental Testing Laboratories
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Linda E. Christenson, Esq.
Executive Director and General Counsel

August 8, 1996

The Honorable Jan Meyers
Chairman, House Committee on Small Business
U.S. House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515-6315

Re: July 16 and July 18, 1996 Small Business Committee Hearings

Dear Representative Myers:

Privatization is an increasingly important issue for the environmental laboratory industry. The International Association of Environmental Testing Laboratories (IAETL), a trade association representing the interests of the private sector environmental testing industry, applauds The House Committee On Small Business' efforts to reduce government and non-profit competition with private industry, in accordance with federal policy as established by OMB Revised Circular A-76.

The most recent White House Conference on Small Business considered the issue of privatization as one of the top priorities for small business. Because government and government sponsored institutions have tax-exempt status, they compete unfairly when they enter into lines of business which are not inherently governmental. This is why Revised Circular A-76 establishes that "the Government shall not start or carry on any activity to provide commercial product or service if the product or service can be produced more economically from a commercial source." Three pending bills are designed to put some teeth in this principle.

H.R. 28 and S. 1724, its Senate companion bill, the Freedom from Government Competition Act, establishes a process by which the Office of Management and Budget will identify those government functions which are commercial in nature, and recommend a plan to the Congress which will lead to those functions being contracted out to the private sector over a five-year period. H.R. 2154, a bill to privatize routine environmental testing analysis would require government departments and agencies to use non-governmental testing laboratories in support of monitoring, assessment, or compliance decision making. IAETL urges the members of the House Small Business Committee to support H.R. 28 and H.R. 2154.

Most commercial laboratories are small businesses providing independent testing services for environmental compliance, public health, and product safety purposes. Private environmental testing labs are facing increasing competition from government and non-profit labs that are seeking ways to acquire additional revenue beyond their traditional government funding sources. Many government sponsored labs now provide routine, repetitive, commercial laboratory services to raise revenue for their operations at the expense of small business operations. Numerous private laboratories have gone out of business and many more are struggling to survive.

Enclosed is IAETL's recent Data Report on Federal and State Government Environmental Testing Analysis Trends. We request that, in addition to this letter, the report be entered into the record for the House Committee on Small Business July 1996 hearings concerning government and non-profit competition.

Sincerely,

Linda E. Christenson, Esq.
Executive Director and General Counsel

IAETL Data Report on Federal and State Government

Environmental Testing Analysis Trends

TESTING THE ENVIRONMENT

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Introduction

Tax-favored competition is competition with private businesses by entities whose status makes them exempt from paying taxes. In the environmental testing industry, this includes not only laboratories run by federal, state and local governments, but also laboratories operated for the government by private corporations under Management and Operations (M&O) contracts. Examples of M&O contract laboratories include Department of Energy laboratories such as Hanford, Oak Ridge, Rocky Flats and others.

The goal of this report is to present the evidence of the growth of tax-favored competition with private environmental testing laboratories in recent years. The data demonstrate that, in many cases, government agencies and tax-favored contractors have been expanding their facilities and operations at the expense of private laboratories, and in other cases tax-favored operations have been kept relatively constant while outsourcing to private laboratories has been cut back substantially.

Some of the data which we have collected shows overall trends in public vs. private sector laboratories, without distinguishing among levels of government in the public sector. At the federal level, we have the most information on Department of Energy laboratories, with lesser amounts on the Department of Defense. Among state laboratories, we have data from nearly a dozen different states which indicate the growth of tax-favored competition. On the local level, our information consists of examples from municipalities, although the trend they represent seems to be widespread.

Federal Government

Within the federal government, the agencies of most relevance to the environmental testing industry with respect to tax-favored competition are the Department of Energy and the Department of Defense. In response to our Freedom of Information Act request, the Department of Energy provided us with their four most recent quarterly Utilization Management Reports which include numbers of samples and total costs for analyses done by commercial laboratories (outsourced) versus those done within the Department's laboratories. DoE uses the percentage of analytical costs done by commercial laboratories, for either non-radioactive samples alone (R0) or for non- and low-radioactivity samples (R0/R1), as a management indicator (MI-2). These data are shown in detail in Appendix 1 of this report.

The decline in commercial laboratory business, using the DoE's own MI2 indicator, is clear from these data: for R0 alone, the percent of business going to commercial laboratories has dropped from 75 to 47% in just one year, and for R0/R1 combined, the decline is from 72 to 51%. The total value of all analyses shows a steep decline in commercial business (from $16.2 million to $7.7 million per quarter), during a time when analyses by DoE's own laboratories actually increased (from $6.5 million to $7.4 million).

These analyses are subject to some caution, since not all DoE sites provided complete information (particularly Hanford). However the DoE itself, in the text which accompanies these data, points out the same trends and refers to them as "an unfavorable direction" (June 20, 1995 report). In fact, their own analysis has found an inverse relationship between the percentage of outsourcing and average cost, so that "cost increases coincide with reductions in commercial laboratory use" (September 29, 1995 report).

Such cost increases have also been found in detailed studies of particular DoE sites. An audit of the Rocky Flats site by the Department's Inspector General found that "the contractor used in-house laboratories to provide analytical services when less expensive and more efficient services were available from subcontract laboratories. As a result, three major programs will incur unnecessary charges of about $2.9 million annually and be required to accept data that is not as timely or reliable as that available from alternative sources."

Among the defects identified in the audit were an average 24% sample analysis failure rate (vs. 3% allowed for commercial subcontractors), and analysis turn-around times which routinely exceeded the one-month standard established for subcontractors. For example 67% of waste identification samples, and 85% of routine bioassay samples, exceeded the one-month standard during the period studied by the DoE's auditors.

An additional phenomenon identified in the DoE's quarterly reports is a reduction in the number of commercial laboratories doing business with the Department. This fell from 42 in the first quarter of FY95, to 29 in the second and third quarters (June 20, 1995 and September 29, 1995 reports). The Department also noted a concentration of business among fewer of the remaining laboratories.

In response to our requests for further information, DoE informed us that they do not have, nor do they anticipate collecting, data on the size, square footage, or number of personnel in their laboratories. They did provide us with the list of laboratories -- both public and private -- which have done work in connection with their environmental management activities, and their addresses and telephone numbers. This list, derived from the Department's DEMSAR data base, includes 82 DoE laboratories and 170 commercial laboratories.

A number of DoE national laboratories are actively seeking new environmental testing business in competition with private laboratories, and are advertising to potential customers. For example, the Los Alamos National Laboratory, a DoE facility operation by the University of California, has advertised itself as a "state of the art facility", and includes among its listed needs "facility is under utilized" and "additional users to help justify full scale operation."

For the Department of Defense, we have not identified a source of aggregate data as with the DoE, and the impression of various IAETL members is that there has not been a general expansionary trend as is apparent in DoE. The recommendation that analyses be centralized and internalized in the Mitre Corporation report on options for cost reductions in environmental assessment, has apparently been definitively rejected and is no longer an option under consideration.

However there have been individual examples of DoD laboratories which have the potential to increase competition. The largest of these is the awarding of a $5.773 million contract to build a new environmental laboratory at Pearl Harbor, Hawaii, for the Navy. The contract for the Pearl Harbor laboratory was announced in the September 5 issue of the Commerce Business Daily. It was awarded to Metric Construction, Inc., a Thousand Oaks, California firm, by the Navy Public Works Center in Hawaii. According to the Navy, this laboratory simply represents the replacement of old and outdated facilities, rather than any initiative to undertake new environmental testing activities which might compete with private laboratories.

State Governments

Many states operate environmental testing laboratories within their departments of health, agriculture, environmental protection, or other agencies, or as part of their state university system. These represent significant sources of competition for private laboratories in many states. Furthermore, since the state laboratories are often responsible for certifying the quality of work performed by private laboratories with which they may be competing, there is a clear conflict of interest issue involved also. Drinking water analyses are a particular area of competition, as well as waste water and other types of analyses.

Among the states in which expansion of tax-favored laboratories and/or upgrading of their capabilities have been carried out or proposed recently, are the following:

- Arizona's Department of Health Services-State Laboratory Services performs work for other agencies of state government such as the Department of Environmental Quality. The state has planned a $17 million laboratory expansion totaling over 50,000 square feet of laboratory space.

- Georgia completed a $20 million, 31,000 square foot expansion of its state laboratory in 1994.

- Hawaii completed a $35 million laboratory facility expansion in 1995; nevertheless the new laboratory is reported not to be very busy.

- Illinois' Department of Health is proposing to offer laboratory services to the public at its cost. Proposed amendments to 77 Illinois Administrative Code 475, published in the Illinois Register on May 5th, 1995, would allow the state to provide analyses of drinking

water, blood specimens, pap smears, fetal proteins and other materials, "to local health departments, family planning clinics, physicians, other health care providers, and the public for the cost of providing the services."

- Iowa has a State Hygiene Laboratory which has been responsible for certifying the private laboratories with which it competed. It undertakes out-of-state as well as in-state business, and in the past has successfully bid for competitive procurements by the federal government. An example is the extensive work it has done for the U.S. Army, working with personnel at Aberdeen Proving Grounds, Maryland.

- Kansas' Department of Health and Environment has made major purchases of equipment for laboratory analyses in recent years: about $700,000 in 1994, $500,000 in 1995 and a recommendation by the Governor for $363,800 for 1995. In addition to drinking water analyses, the Department does all the laboratory work for blood lead screening also.

- North Carolina's House Bill 930 in the 1995 session of the General Assembly would have reopened the state Department of Health, Environment and Natural Resources' Laboratory of Public Health for drinking water analysis. This would cost $1.3 million in capital expenditures and $1.1 million annually in operational costs. This comes despite the fact that the state Department of Health, Environment and Natural Resources does not support the expansion. The state laboratory stopped providing drinking water testing services after 1988, as a result of negotiations with private laboratories which led to the private laboratories' adopting increased certification requirements.

- South Carolina's Bureau of Environmental Quality Control Laboratories recently gained 2400 square feet of laboratory space through transfer of non-laboratory staff to other buildings, and currently employs about 65 persons involved in sample testing and 30 others involved in laboratory certification and monitoring. Its most recent expansion cost about $ 2 million.

- The Texas Department of Health does all the state's drinking water chemistry testing, as well as all compliance testing analyses. The state certifies public laboratories for microbiological analyses (89 are currently certified), but private laboratories are certified for this work only as "circumstantial" exceptions, with only 3 or 4 private laboratories currently being certified.

- Utah's State Health Laboratory performs about 60% of all Utah drinking water analyses. Since the state is responsible for enforcing environmental laws pertaining to drinking water, a potential conflict-of-interest situation exists. University laboratories at Utah State and Brigham Young University also compete significantly with private laboratories in the areas of soil and food chemistry and microbiology.

- Wisconsin's Occupational Health Laboratory analyzes samples on a fee-for-service basis in the fields of environmental and industrial hygiene. In addition, this laboratory

has an ongoing contract with OSHA, for which private laboratories have not had an opportunity to compete, which has brought in several million dollars of revenue. Wisconsin also planned an expansion of its state drinking water laboratory costing about $18 million, to be more than 50% funded by outside fee samples; these plans are currently on hold.

Local Governments

While the large number of local governments in the US makes it unfeasible to collect general data on this sector, we have been receiving reports of the expansion of city laboratories into competition with IAETL members. A recent example is the decision of the city of Oxnard, CA to use its city water laboratory to do commercial work.

The city's strategy was reported in September 1995 in the Oxnard *Star*. Wanting to increase revenues without raising sewer rates, Oxnard directed its city chemist and his staff to begin doing analyses for commercial industries. This work directly competes with local private laboratories. Such examples, although anecdotal, do help to demonstrate the widespread nature of the problem.

Employment Trends

The effects of the growth in tax-favored competition on employment in our industry can be seen in figures published by the Department of Labor's Bureau of Labor Statistics. The Bureau carries out monthly surveys, published in their "Current Employment Statistics Survey", which break down employment figures into several hundred industrial categories. The category which includes environmental testing laboratories is # 8730: Research and testing services. For the purposes of employment data, this is broken down into three industry codes: 8731 - Commercial physical research, 8732 - Commercial non-physical research, and 8733, Non-commercial physical research. According to the Bureau, 8732 consists primarily of computer-related laboratories. More specific industry codes which distinguish testing laboratories from other kinds of laboratories, do not separate out commercial and non-commercial laboratories.

The following table gives the data for the 8731 and 8733 industry codes since 1988. Employment in the commercial sector peaked in 1991, and since then it has declined by 7.7%. Among non-commercial laboratories, on the other hand, it has been stable, with only an 0.5% drop in the work force between 1991 and 1994.

Employment (thousands)

	Code	
Year	8731	8733
1988	212.6	132.6
1989	221.6	140.1
1990	234.8	141.9
1991	240.3	138.5
1992	237.6	140.6
1993	237.7	141.4
1994	227.7	136.7
1995	221.9	137.8

We suspect that the fall-off in laboratory activity is considerably greater than indicated by the employment data. It is also likely that for environmental laboratories, the difference in trends between the commercial and non-commercial sectors is more dramatic than indicated by these data, which combine environmental laboratories with other kinds of laboratory work.

Conclusions

The data and examples we have found so far indicate that tax-favored competition is a broad and growing phenomenon. The DoE data show that it has led to a substantial fall-off in business for commercial laboratories, and the BLS surveys indicate that this is having a negative impact on employment as well. Examples at the state and local levels show that it is happening in those sectors as well. Taken together, this evidence indicates that tax-favored competition is a growing problem in our industry. This is the basis for our efforts in support of both the Environmental Testing Privatization Act of 1995 (H.R. 2154) and state-level legislative proposals.

This problem is increasing despite the clear policy of the Federal Government. The Office of Management and Budget's Revised Circular A-76, on "Performance of Commercial Activities", establishes the principle that "In the process of governing, the Government should not compete with its citizens..... it has been and continues to be the general policy of the Government to rely on commercial sources to supply the products and services the Government needs." In light of this principle, OMB established as a matter of policy that "The Federal Government shall rely on commercially available sources to provide commercial products and services. In accordance with the provisions of this Circular, the Government shall not start or carry on any activity to provide commercial product or service if the product or service can be produced more economically from a commercial source."

IAETL believes that it is now time to reinvigorate these principles in the field of environmental testing.

APPENDIX 1

Total Cost of Laboratory Analyses done for DoE, Commercial vs. In-house
(Quarterly Data from DoE Utilization Management Reports)

Report, Quarter	Radiation Type	Commercial	Within DOE	Total Cost	Percent Comm.
19-Jan-95	R0	$ 11,131,119	$ 3,697,513	$ 14,828,632	75%
(FY94Q4)	R1	$ 5,003,362	$ 2,689,943	$ 7,693,305	65%
	R2	$ 64,021	$ 30,029	$ 94,050	68%
	R3	$ -	$ 13,753	$ 13,753	0%
	R4	$ -	$ 28,913	$ 28,913	0%
	Total	$ 16,198,502	$ 6,460,151	$ 22,658,653	71%
	R0 alone	$11,131,119.00	$3,697,513.00	$14,828,632.00	**75%**
	R0/R1	$16,134,481.00	$6,387,456.00	$22,521,937.00	**72%**
31-Mar-95	R0	$ 8,094,949	$ 2,361,025	$ 10,455,974	77%
(FY95Q1)	R1	$ 3,097,065	$ 2,958,717	$ 6,055,782	51%
	R2	$ 17,336	$ 13,125	$ 30,461	57%
	R3	$ 66,026	$ -	$ 66,026	100%
	R4	$ 6,908	$ 27,225	$ 34,133	20%
	Total	$ 11,282,284	$ 5,360,092	$ 16,642,376	68%
	R0 alone	$ 8,094,949.00	$2,361,025.00	$10,455,974.00	**77%**
	R0/R1	$11,192,014.00	$5,319,742.00	$16,511,756.00	**68%**
20-Jun-95	R0	$ 7,837,724	$ 6,846,043	$ 14,683,767	53%
(FY95Q2)	R1	$ 1,714,908	$ 2,022,785	$ 3,737,693	46%
	R2	$ -	$ 14,250	$ 14,250	0%
	R3	$ 61,446	$ 13,146	$ 74,592	82%
	R4	$ 62,024	$ 25,425	$ 87,449	71%
	Total	$ 9,676,102	$ 8,921,649	$ 18,597,751	52%
	R0 alone	$ 7,837,724.00	$6,846,043.00	$14,683,767.00	**53%**
	R0/R1	$ 9,552,632.00	$8,868,828.00	$18,421,460.00	**52%**
29-Sep95	R0	$ 4,645,305	$ 5,143,816	$ 9,789,121	47%
(FY95Q3)	R1	$ 3,042,213	$ 2,167,264	$ 5,209,477	58%
	R2	$ -	$ 9,825	$ 9,825	0%
	R3	$ 178,007	$ 59,470	$ 237,477	75%
	R4	$ 109,878	$ 34,875	$ 144,753	76%
	Total	$ 7,975,403	$ 7,415,250	$ 15,390,653	52%
	R0 alone	$ 4,645,305.00	$5,143,816.00	$ 9,789,121.00	**47%**
	R0/R1	$ 7,687,518.00	$7,311,080.00	$14,998,598.00	**51%**

APPENDIX 2

Article for *IAETL Environmental Advocate*

Department of Energy and Employment Data Show Recent Growth of Tax-Favored Competition

In recent months, IAETL staff have been tracking down and analyzing data on the growth of tax-favored competition with commercial environmental testing laboratories. These figures clearly show that such competition has been growing, even at a time of governmental cutbacks, and that it is causing substantial job losses.

The most evident and rapid change has come in the Department of Energy. The Department's quarterly Utilization Management Reports show that the percentage of analytical testing which was outsourced (done by commercial laboratories) has dropped from around three-fourths to about one-half in just one year -- between July 1994 and June 1995. The decline is particularly striking for non-radioactive samples, for which outsourcing dropped from 75% to 47% over this period.

Overall, commercial laboratories' analytical testing business with the DoE was cut in half during this year, from $ 16.2 million in the June-September 1994 quarter to $ 7.7 million in April-June 1995. Over this same period, analytical testing costs for the DoE's own laboratories increased from $ 6.5 million to $ 7.4 million.

The Department's own reports refer to these trends as "an unfavorable direction". In fact, their own analysis has found an inverse relationship between the percentage of outsourcing and average cost, so that "cost increases coincide with reductions in commercial laboratory use."

Such cost increases have also been found in detailed studies of particular DoE sites. An audit of the Rocky Flats site by the Department's inspector general found that "the contractor used in-house laboratories to provide analytical services when less expensive and more efficient services were available from subcontract laboratories. As a result, three major programs will incur unnecessary charges of about $2.9 million annually and be required to accept data that is not as timely or reliable as that available from alternative sources."

Among the defects identified in the audit were an average 24% sample analysis failure rate (vs. 3% allowed for commercial subcontractors), and analysis turn-around times which routinely exceeded the one-month standard established for subcontractors. For example 67% of waste identification samples, and 85% of routine bioassay samples, exceeded the one-month standard during the period studied by the DoE's auditors.

Obviously, the decline in business for commercial laboratories because of tax-favored competition will have effects on jobs. This is in fact what IAETL staff have found, using data from the federal Department of Labor's Bureau of Labor Statistics.

According to these figures, employment trends in commercial versus non-commercial research and testing laboratories have shown clear differences in the 1990s. While employment peaked in both sectors in 1991, it has dropped by 7.7% among commercial laboratories since then. Among non-commercial laboratories, on the other hand, it has been stable, with only an 0.5% drop in the work force between 1991 and 1994.

The same trends seem to be occurring at the state and local levels. Recent news of laboratory expansions in several states, and of municipal water testing laboratories in California beginning to compete with the private sector, demonstrate that the incidence of tax-favored competition is widespread. IAETL will be continuing to analyze and disseminate data which show the magnitude of this problem.

APPENDIX 3

Article for *Environmental Laboratory* - "IAETL Bulletin" Section

Evidence Grows on Tax-Favored Competition

National Data Shows Employment Drop

IAETL has begun to accumulate evidence on the growth of tax-favored competition with commercial environmental testing laboratories in recent years. This is coming about because of pressure on government laboratories to find new sources of revenues, in face of cutbacks in their traditional activities.

Employment trends in commercial versus non-commercial research and testing laboratories show clear differences. While employment peaked in 1991, according to data from the Bureau of Labor Statistics of the U.S. Department of Labor, it has dropped by 7.7% among commercial laboratories since then. Among non-commercial laboratories, on the other hand, it has been stable, with only an 0.5% drop in the work force between 1991 and 1994.

We suspect that the fall-off in laboratory activity is considerably greater than indicated by the employment data. It is also likely that for environmental laboratories, the difference in trends between the commercial and non-commercial sectors is more dramatic than indicated by the BLS data, which combine environmental testing laboratories with some other kinds of laboratory work. IAETL is presently in the process of gathering more evidence, both from its members and from official government sources, to demonstrate this.

Some Examples

A recent example of the trend toward tax-favored competition comes from Ventura Country, California, where the city chemist of Oxnard and his staff at the city waste-water treatment plant have begun doing environmental laboratory analyses for local industry to raise money. Faced with pressure from the City Council to come up with additional revenue without increasing sewer rates, they have begun using their non-tax-paying facilities to compete with local laboratories, such as FGL Environmental in Santa Paula, California.

This sort of expansion is going on at the federal level also. The Commerce Business Daily recently published notice of a contract award, for construction of an Environmental Laboratory at the Navy Public Works Center in Pearl Harbor, Hawaii. The contract, given to a California construction firm, is worth $5.773 million.

Criticism of Tax-Favored Laboratories' Work

This expansion of tax-favored laboratories' environmental testing is occurring despite evidence that they are often slower and less efficient than their non-tax-favored competitors. A recent audit of the contractor running the Rocky Flats site in Colorado, done by the Department of Energy's inspector general, concluded that "the contractor used in-house laboratories to provide analytical services when less expensive and more efficient services were available from subcontract laboratories. As a result, three major programs will incur unnecessary charges of about $2.9 million annually and be required to accept data that is not as timely or reliable as that available from alternative sources."

Among the defects identified in the audit were an average 24% sample analysis failure rate (vs. 3% allowed for subcontractors), and analysis turn-around times which routinely exceeded the one-month standard established for subcontractors. For example 67% of waste identification samples, and 85% of routine bioassay samples, exceeded the one-month standard during the period studied by the DoE's auditors. The audit report recommended that M&O contractors be required to perform make-or-buy analysis of their environmental testing programs, to determine whether commercial subcontractors could do the work more cheaply and efficiently.

APPENDIX 4

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FOR IMMEDIATE RELEASE **Contact:** **Linda Christenson**
Date: October 13, 1995 **Executive Director, IAETL**
Telephone: **703/739-2188**

TAX SUBSIDIZED GOVERNMENT LABORATORY COMPETITION DOES NOT SAVE TAXPAYERS MONEY

(October 13, 1995, Alexandria, VA) The International Association of Environmental Testing Laboratories (IAETL), commenting on the decision of the city of Oxnard, CA to use its city water laboratory to do commercial work in competition with private laboratories, said that such competition from tax-subsidized institutions is unfair, inefficient, and results in loss of tax revenue.

The city's strategy was reported last month in the Oxnard *Star*. Wanting to increase revenues without raising sewer rates, Oxnard directed its city chemist and his staff to begin doing analyses for commercial industries. This work directly competes with local private laboratories.

"This kind of tax subsidized competition does not save taxpayers money," commented Linda Christenson, IAETL's Executive Director. "It simply hides the costs, which are paid in the form of tax subsidization of government laboratories and results in the loss of tax revenue from the private sector."

IAETL is supporting federal legislation to prevent tax-favored government laboratories from unfairly competing with the private sector. One of the pending bills, called the "Environmental Testing Privatization Act of 1995," was introduced in the House of Representatives, on August 1, by Rep. William O. Lipinski (D-IL) as H.R. 2154 and has bipartisan support. Representative Rob Andrews (D-NJ) has requested the Congressional Budget Office (CBO) to "score" the bill. The CBO will analyze the savings that HR 2154 would, if enacted, create in the federal budget and report back to Representative Andrews.

Private-sector laboratories have been losing business -- and jobs -- because of competition from tax-favored laboratories in recent years. IAETL's 170 members, which represent two-thirds of the revenue generated in the $1.4 billion commercial environmental analytical testing industry, have made opposition to tax-favored competition a major priority.

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APPENDIX 5

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FOR IMMEDIATE RELEASE **Contact:** **Linda Christenson**
Date: October 13, 1995 **Executive Director, IAETL**
Telephone: **703/739-2188**

IAETL DENOUNCES MOVE TO BUILD NEW GOVERNMENTAL LABORATORY

(October 13, 1995, Alexandria, VA) The International Association of Environmental Testing Laboratories (IAETL) today criticized the awarding of a $5.773 million contract to build a new environmental laboratory at Pearl Harbor, Hawaii, using taxpayers' money. The Association, which represents private-sector laboratories that test water, air, hazardous and solid wastes, low level radioactive substances and other materials, said that such laboratories represent unfair tax-subsidized competition with the private sector and unnecessarily duplicate more efficient facilities that already exist.

The contract for the Pearl Harbor laboratory was announced in the September 5 issue of the *Commerce Business Daily*. It was awarded to Metric Construction, Inc., a Thousand Oaks, California firm, by the Navy Public Works Center in Hawaii.

Commenting on the $5.8 million contract, IAETL's Executive Director Linda Christenson said, "At a time when private environmental testing laboratories have surplus capacity and the federal budget is being pared back, it makes no sense to be building new government laboratories to compete with the private sector. Such tax-favored competition is one of the major reasons why employment in commercial research and testing laboratories has been dropping for the past several years."

Christenson pointed out that studies of in-house environmental testing at government sites, such as the audit of Rocky Flats last year by the Department of Energy's Inspector General, have found that private laboratories have higher standards of accuracy and complete their analysis in a shorter time.

"There is no need to be spending the money of the American taxpayer to create unfair competition with private environmental laboratories," said Christenson. "IAETL's member companies are able and willing to take on the analyses required to protect and clean up our environment, and will save the government money in the process as well as generate additional tax revenues."

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Presentation by the International Association of Environmental Testing Laboratories (IAETL)

to the Privatization Stakeholders' Symposium

April 23-24, 1996
Alexandria, VA

IAETL

OMB Circular A-76

"The Federal Government shall rely on commercially available sources to provide commercial products and services. In accordance with the provisions of this Circular, the Government shall not start or carry on any activity to provide commercial product or service if the product or service can be produced more economically from a commercial source."

What is Government-Sponsored Competition?

- Private Laboratories pay taxes
- When Government and Government-Contractor Labs compete with Private Labs, their tax-favored status gives them an advantage

The Costs of Government-Sponsored Competition

- When Government Labs take business away from the Private Sector, the taxpayers are paying for it
- The true cost to the government includes:
  - The taxes lost
  - Fixed costs ,irrespective of how much work is done
  - Associated variable costs for operating labs, including salaries, supplies, health and safety, quality assurance, waste disposal

Government-Sponsored Competition in Department of Energy laboratories

- Dramatic growth in 1994-1995
- Recognition of the problem by DoE
- An example - the Rocky Flats audit

DoE's National Sample Tracking System (NSTS)

- Data collected from major DoE labs
- Compiled in quarterly Utilization Management Reports
- Sample numbers and analysis costs by radiation type (R0 to R4)
- Separated into Commercial and within-DoE (i.e... government-sponsored)

IAETL

Dramatic Change from mid-94 to mid-95

- Commercial business cut in half while DoE business grew slightly
- "Outsourcing" (in $) dropped from three-fourths to half of analyses in just one year
- Same pattern for number as for total dollar value of analyses
- Particularly evident for non-radioactive (R0) samples - drop from 75% to 47%

IAETL

The Drop in DoE Commercial Lab Analyses, 1994-95

Extent of the change

- Commercial laboratory revenues for analyses dropped from **$16.2** million to **$7.7** million per quarter

- Internal DoE laboratory revenues increased from **$6.5** million to $ **7.4** million per quarter

IAETL

DoE's own analysis of this trend

- Referred to the decrease in outsourcing as "an unfavorable direction" (June 20, 1995 quarterly report)
- Found an inverse relationship between the percentage of outsourcing and average cost per analysis
- Thus, "cost increases coincide with reductions in commercial laboratory use" (September 29, 1995 quarterly report)

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An Example - the Rocky Flats audit

- Performed by DoE's Inspector General
- Studied "Effectiveness and Efficiency of the Rocky Flats Analytical Services Program"
- Report issued November 3, 1994

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Results of the Rocky Flats audit

- "the contractor used in-house laboratories to provide analytical services when less expensive and more efficient services were available from subcontract laboratories."
- "As a result, three major programs will incur unnecessary charges of about $2.9 million annually and be required to accept data that is not as timely or reliable as that available from alternative sources."

Defects identified - Rocky Flats audit

- 24% average sample analysis failure rate (vs. 3% allowed for external subcontractors)

- Turn-around times which routinely exceed established standards; e.g.. one-month standard was exceeded for:
  - 67% of waste identification samples
  - 85% of routine bioassay samples

IAETL

The IG's Recommendation

- Require Rocky Flats contractor to perform "make-or-buy" analysis of lab analytical services, including:
  - cost comparison between internal contractor-provided and alternative sources of services
  - evaluation whether efficiency improvements such as timeliness of delivery and quality, are available from alternative sources
  - documentation of the support used for selecting how analytical services will be provided

The Department of Defense

- The Mitre Corporation Report
- What are the general trends and perceived policies?

The Mitre Corporation Report

- Concerning options for cost reduction in DoD environmental assessment
-
- Recommended centralization and internalization of lab analyses
-
- This recommendation has apparently not been adopted

DoD - general trends and policies

- We have not identified an aggregate source of data comparable to the DoE's National Sample Tracking System
- Impression of IAETL members is that government-sponsored competition for DoD business is **not** generally increasing
- However, cases such as the Mitre report's recommendations raise questions
- Is there a general policy?

IAETL

Same Trend Seen at Other Levels of Government

- State lab construction and expansion
- Local government labs competing with commercial sector

Examples of States Expanding their Environmental Laboratories:

- Arizona - $17 million expansion planned
- Georgia -$20 million expansion, 1994
- Hawaii - $35 million expansion, 1995
- Kansas - major equipment purchases
- North Carolina - lab reopening proposed
- South Carolina - $2 million expansion
- Wisconsin - $ 18 million expansion proposed

IAETL

Examples of State Laboratories Competing with the Private Sector

- Connecticut
- Iowa
- Illinois - proposed
- Kansas
- North Carolina - proposed
- Texas
- Utah
- Wisconsin

Local Governments Pushing their Municipal Labs to Compete with the Commercial Sector

- Example of the city of Oxnard - Ventura County, California
  - City water lab instructed to raise more revenue without increasing water rates
  - Has begun doing lab analyses for local industries
  - Directly competing with private labs - e.g.. FGL Environmental

Legislative Efforts

- HR 2154, the Environmental Testing Privatization Act of 1995
- HR 28 - study (for DoD only) incorporated into the Defense Authorization bill
- HR 1670 - Federal Acquisition Reform Act of 1995 - passed the House
- HR 1510 - Department of Energy regulation implementation
- HR 2405, Omnibus Science Authorization
- incorporates NSF Important Notice 91

General Principles

- Need for make-or-buy analyses for laboratory work

- Governmental labs should not be undertaking work which commercial labs are able to do efficiently, accurately, rapidly and cost-effectively

IAETL

"In the process of governing, the Government should not compete with its citizens..... it has been and continues to be the general policy of the Government to rely on commercial sources to supply the products and services the Government needs"

OMB Circular A-76

THE UNIVERSITY OF IOWA

August 7, 1996

Representative Jan Meyers
Chair, Committee on Small Business
2303 Rayburn House Office Building
Washington, DC 20515-1603

Dear Representative Meyers:

Thank you for the opportunity to provide a written response to the testimony of Michael K. McGee, Division Manager, National Environmental Testing, Inc., Cedar Falls Division, who testified on behalf of the International Association of Environmental Testing Laboratories and the ACIL (formerly the American Council of Independent Laboratories) before the U.S. House of Representatives Committee on Small Business on July 18, 1996. Because the University of Iowa Hygienic Laboratory (UHL) was featured prominently in this testimony by a division director of one of the largest environmental laboratories in the nation, we would like to provide some background on the Hygienic Laboratory and correct several inaccuracies in the testimony that was given before your committee.

The State of Iowa Hygienic Laboratory (now UHL) was established by the Iowa General Assembly in 1904. The Assembly directed that the laboratory be a permanent part of the University of Iowa and provide needed analytical services, consultation and training in environmental and public health. These functions are explicit in the Code of Iowa and the Iowa Administrative Code (copies attached), relating specifically to UHL and not necessarily to other university laboratories or other state laboratories since each state and territory is organized differently. This action was taken in the belief that protection of public health and safety was a necessary and proper function of government and that placement of this service within a University setting would provide ready access to a broad range of scientific and technical resources. Although admininstratively part of the University, the UHL is the State of Iowa's public health and environmental laboratory, and both the Iowa District Court and Iowa Supreme Court have ruled that the activities of the UHL are within its legislative mandate as the state

HYGIENIC LABORATORY

102 Oakdale Campus, #H101 OH
Iowa City, Iowa 52242-5002
319/335-4500

Iowa's Environmental and Public Health Laboratory

Telefax: 319/335-4555

laboratory. In the nine decades of its existence the laboratory has established an outstanding record of service to the state.

In the third paragraph of testimony Mr. McGee states that "Neither Iowa nor Wisconsin have accounting systems in place so they do not know what it costs them to perform individual tests..." We cannot speak for the state of Wisconsin, but we can assure you that the University of Iowa Hygienic Laboratory has in place accounting systems which are subject to audit by the state of Iowa. These accounting systems have always met the accounting requirements imposed on the laboratory and the University. As Mr. McGee should be aware, environmental samples can range from straightforward tests on clean materials like drinking water to exploratory work on very difficult and contaminated matrices like sludges and drum residues, so of course there must be some degree of uncertainty in such figures.

Paragraph 4 of the testimony states that "They [University Hygienic Laboratory] are not subject to audits by other State of Iowa personnel to ensure compliance with state certification requirements." In fact, however, the University Hygienic Laboratory, and all public laboratories, are subject to the same certification requirements as private laboratories. Public laboratories must seek certification from federal, state and private certification bodies in order to continue to provide service to the public.

The same paragraph suggests that the Hygienic Laboratory has a conflict of interest in its mandate to certify private laboratories. Although the University Hygienic Laboratory uses technically conversant analysts to conduct on-site audits as required for State of Iowa certification, UHL has created a firewall of separation between its operational and certification functions which is further strengthened by the fact that the accrediting authority in the state is the Iowa Department of Natural Resources which receives the recommendation of the audit team and issues final certification. This separation itself is subject to review and audit. Moreover many private laboratories perform the same dual functions of laboratory testing and certification, and UHL is accredited in several fields by such auditors from private accrediting bodies such as the American Industrial Hygiene Association. We would recommend that these laboratories, too, create a separation between the two functions and that these be subject to audit.

Paragraph 5 of the testimony states that laboratories like the University Hygienic Laboratory "transfer federal funds received under grants and contracts, subsequently used to fund commercial operations." In fact, such allegations are untrue. Transfer of federal funds for use in commercial operations is forbidden by federal law and regulation. This particular violation of law is subject to criminal penalty.

The same paragraph points out that state laboratories "[avoid]...real estate, sales, and state and federal income taxes." It is true that governmental entities do not as a rule pay taxes to one another; this public policy was put in place to provide governmental checks and balances and not as a means to either further or inhibit commercial interests.

Paragraph 5 also talks about state laboratories "marketing the 'halo effect' whereby their organization is presented as having no profit motive which presumably 'corrupts' the quality of services provided by commercial laboratory operations." The University of Iowa Hygienic Laboratory has established its reputation based upon the quality and steadfastness of its service as a public entity; we make no apologies for this well earned and valued reputation. We cannot agree that this carries with it the implication that private firms have been corrupted. In recent years, a few commercial laboratories have participated in fraudulent practices which have been uncovered by public agencies, but we are not aware of any case where these unfortunate incidents have been used in "marketing" by any public sector laboratory.

The final paragraphs of testimony provide recommendations for new policies. The first urges that policies be developed "limiting the use of all federal contracts and grants from use in supporting commercial operations of nonprofit groups..." Current law is already applicable to the transfer of funds for use in commercial activity. Here we must point out that not all grants and contracts are issued for research purposes; some are applied to training, some to public education and still others to provision of services. The government issues grants and contracts to support small businesses as well as public entities.

A second recommendation urges the imposition of a sales tax for the provision of state services. We do not know whether this is tenable as a matter of state or federal law, but we do not believe this would have broad public support.

A third recommendation urges a national certification program for laboratories. While many public services have national standards and guidance, each state reserves unto itself the powers to regulate certain activities within its own jurisdiction. The foremost of these powers of regulation relate to public health and safety, including laboratory generation of data in response to public health and environmental laws and regulations. We would point out that the State of Iowa certification program has always actively encouraged reciprocal certification between states, and that the state is an active participant in the recently established National Environmental Laboratory Accreditation Conference, established explicitly to provide standards for a uniform national program.

A fourth recommendation has to do with creating legislation and policy that can be enforced through the courts. While the law cited in testimony appears to be state law rather than federal, the goal of "good law" is laudable. We believe that in the case he cites the plaintiffs received full and fair consideration under the law, including their appeal to the state supreme court, and that the decision was just.

The true contribution to protection of public health and the environment in this country has come from Federal and State programs and regulations, and the supporting efforts of public laboratories, not private laboratories as Mr. McGee suggests. The current existence of excess capacity in private sector laboratories is due to the diminishing of a market that was established as a result of long years of Public laboratory efforts. A lack of foresight, planning and profits in the private sector is insufficient reason to abandon the public laboratory capacity needed to address threats to public and environmental health. It is doubtful the public can depend on private industry to come to their aid if monetary loss is the obvious result. State laboratories respond to these needs and must be maintained. When a public water supply is flooded--as happened in our capitol city in 1993--or a spill of toxic chemicals occurs it is not the time to seek out expertise and purchase equipment. While assistance to, and protection of, small businesses in Iowa and across the nation is central to economic well-being, the protection of public health is more important as the state's economic well-being can not be maintained or

prosper without a healthy public and clean environment. In this case, we do not believe that the interests are mutually exclusive.

Thank you once again for the opportunity to comment on this testimony.

Sincerely,

Mary J. R. Gilchrist

Mary J. R. Gilchrist, Ph.D.
Director

Enclosures: Code of Iowa
Iowa Administrative Code

CHAPTER 263

UNIVERSITY OF IOWA

263.7 State hygienic laboratory — investigations.

The state hygienic laboratory shall be a permanent part of the state University of Iowa. It shall make or cause to be made microbiological and chemical examinations and other necessary investigations by both laboratory and field work in the determination of the causes of disease, shall suggest methods of overcoming and preventing the recurrence of the disease, and shall evaluate environmental effects and scientific needs, whenever requested to do so by any state agency, state institution, or local board of health when the investigation or evaluation is necessary in the interest of environmental quality and public health and for the purpose of preventing epidemics of disease.

[S13, §2575-a8; SS15, §2575-a7; C24, 27, 31, 35, 39, §3953; C46, 50, 54, 58, 62, 66, 71, 73, 75, 77, 79, 81, §263.7]

263.8 Reports — tests.

Charges may be assessed for transportation of specimens and cost of examination. Reports of epidemiological examinations and investigations shall be sent to the responsible agency.

In addition to its regular work, the laboratory shall perform without charge all bacteriological, serological, and epidemiological examinations and investigations which may be required by the Iowa department of public health and said department shall establish rules therefor. The laboratory shall also provide, those laboratory, scientific field measurement, and environmental quality services which, by contract, are requested by the other agencies of government.

The laboratory is authorized to perform such other laboratory determinations as may be requested by any state institution, citizen, school, municipality or local board of health, and the laboratory is authorized to charge fees covering transportation of samples and the costs of examinations performed upon their request.

[S13, §2575-e8; SS15, §2575-a7,-a9; C24, 27, 31, 35, 39, §3953; C46, 50, 54, 58, 62, 66, 71, 73, 75, 77, 79, 81, §263.8]

Duties of department of health, §135.11

CHAPTER 5
STATE HYGIENIC LABORATORY
[Prior to 4/20/88, Regents, Board of(720)]

GENERAL REGULATIONS

681—5.1(263) Scope of services.

5.1(1) *Scientific.* The laboratory provides analytical services primarily in the areas of communicable disease control and in the assessment of environmental quality.

5.1(2) *Consultative.* The professional staff of the laboratory is available for consultative assistance to persons with interest or involvement in public health.

5.1(3) *Training.* Facilities and staff of the laboratory are available for the training of laboratorians, environmentalists, and public health specialists as the need arises through workshops, seminars, and individualized instruction.

681—5.2(263) Specimens examined.

5.2(1) *Classification.* This being the state public health and environmental laboratory, specimens submitted to it should have a direct or probable significance to public health, medical management, or the quality and preservation of the environment.

5.2(2) *Who may submit specimens*

a. Licensed physicians, osteopathic physicians, and other licensed practitioners may submit specimens for the diagnosis and control of communicable or other diseases in which such tests are required by the state department of public health.

b. Veterinarians may submit specimens involving diseases of animals which are communicable to humans.

c. State department of public health may submit specimens necessary in the conduct of its fundamental responsibilities. Other programs, services, and studies may be negotiated on a contractual basis.

d. The natural resources department may submit specimens necessary in the conduct of its fundamental responsibilities relative to municipal water supplies. Other programs, services, and studies may be negotiated on a contractual basis.

e. Other state agencies, institutions, and municipalities may submit specimens, generally under a contractual arrangement if the submission is to be of a regular and routine nature.

f. Local departments of health may submit specimens when performing official functions of state regulatory agencies. The examination of other specimens necessary in the support of locally directed programs are provided only with prior clearance and cost negotiations.

g. Private individuals may submit specimens to determine the suitability and safety of private water supplies only when collected and received according to conditions prescribed by the laboratory and accompanied by the appropriate fee.

h. Privately owned industries and businesses may submit specimens for environmental studies by prior arrangement with the laboratory on a fee basis.

i. Public schools may submit specimens at the discretion of the school nurse, consulting physician, principal, or upon recommendations of the local department of health.

681—5.3(263) Charges.

5.3(1) *Specimens examined free of charge:*

a. Specimens submitted relating to diseases communicable from human to human, from animals to human, provided such examinations are required by rules of the state department of public health.

b. Specimens submitted under statutory authority by state agencies or designees of state agencies which are involved in investigations or episodes challenging the health of the public or the quality of the environment.

c. Any specimen when there is probable cause that a direct threat to public health exists.

5.3(2) *Specimens for which fees are charged:*

a. Specimens submitted under no statutory authority which are part of special investigations or surveillance programs and where there is no direct threat to the public

health or environmental quality.

b. Specimens submitted for the submittor's private information, such as well water samples.

c. Specimens submitted by private concerns and municipalities which are considered to be product quality control measures and, therefore, a cost of doing business.

d. Specimens not covered by statute, by rules of the state department of health, by rules of the natural resources department or in this subrule, may be examined and charged for at rates to be determined by the state board of regents subject to any limitations imposed by law.

This rule is intended to implement Iowa Code chapter 263.

[Filed 9/29/52; amended 5/19/75]

[Filed 3/29/88, Notice 2/10/88—published 4/20/88, effective 5/25/88]

S-F ANALYTICAL LABORATORIES, INC.

A Subsidiary of Sommer Frey Laboratories, Inc.

July 8, 1996

House Small Business Committee
2361 Rayburn House Office Building
Washington, D.C. 20515-6315

Dear Chairman Meyers and Members of the Committee:

The Wisconsin Environmental Laboratories Association (WELA) has long been concerned with the increasing competition from government and tax-favored laboratories. As Chairman of a special subcommittee on competition with the public sector, I received numerous complaints from our member laboratories - complaints that go unanswered or are simply dismissed. While we continue to seek relief from the Wisconsin Legislature, none has been forthcoming. As a lab owner, it is most frustrating to face ever increasing government competition in an already competitive market.

The answer to lowering government expenditures is to downsize - not to offer goods and services to the public that are already provided by the private sector as a means of subsidizing budgets without reducing payroll.

Attached is an abbreviated version of testimony recently given to a Wisconsin Senate Committee which demonstrates the difficulties we face. Although the examples cited deal with state laboratories, the same problems exist with federal labs. Please include this letter and its attachment as part of your hearing record for your July 16 and July 18, 1996 hearings on government competition.

We join the Business Coalition for Fair Competition in asking you for relief from both government and nonprofit competition. The laboratory sector of our economy may be small, but, as a delegate to the White House Conference on Small Business in 1995, I know that government competition affects many other sectors, as well.

Sincerely,

Edward F. Treick
Chairman, Government and Tax-Favored Competition Committee
Wisconsin Environmental Laboratories Association.

6125 West National Avenue, P.O. Box 14513, Milwaukee, Wisconsin 53214
(414) 475-6700 FAX: (414) 475-7216
Toll-Free: 800-300-6700

• Dept. of Health State Certified Laboratory #168 • Dept. of Natural Resources State Certified Laboratory #241249360 •
• USDA Accredited Laboratory #5581 • NIOSH Proficiency Analytical Testing Program •

STATEMENT OF EDWARD F. TREICK
CHAIRMAN, WISCONSIN ENVIRONMENTAL LABORATORIES ASSOCIATION
SUBCOMMITTEE ON GOVERNMENT & TAX-FAVORED COMPETITION

Because I have been deeply involved with the issue of government and tax-favored competition for the past ten years, I have been able to observe a definite change in the intensity of competition we face from the tax supported labs. As recently as eight years ago, state agencies expressed surprise that their activities were affecting the livelihoods of private labs. Superficial efforts were even made to change wording in Wisconsin Department of Natural Resources (WIDNR) pamphlets, and, as recently as 1988, letters were sent to firms, individuals and private labs informing them that future regulations would require them to utilize private labs.

This seemingly cooperative environment began to change about six years ago when we became aware that the testing for which we had made major capital investments might be performed at the Wisconsin State Laboratory of Hygiene (WISLOH) instead. A WIDNR report to the legislature in 1989 insinuated that private labs, certified by the WIDNR as competent, were not capable of providing accurate data. Since that time, our concern that the WISLOH would directly compete with us has become a moot point. More and more, work that should be done in the private sector is being directed to the State Lab of Hygiene (WISLOH) through the WIDNR and Wisconsin Department of Health and Social Services (WIDHSS). Recent discussions with the WISLOH have turned from denial of competition to assertions that the legislature sanctions this competition by requiring the WISLOH to generate program revenue. The WISLOH Board is currently formulating a policy that would even allow volume discounts to non-government agencies.

To help you understand the scope of the competition problem, I would like to review with you some of the complaints our committee receives. None of the cases presented today is old - I have only reached back to August, 1995. No two complaints I am presenting were brought by the same lab. (Complaints cover only governmental labs, since the scope of the original hearing dealt mainly with the University of Wiscosin labs, including the State Laboratory of Hygiene).

On May 3 of this year, a letter from the WIDNR was sent to the customer of an environmental lab in northern Wisconsin. The letter notified the customer that it had failed to properly report test results. It went on to insinuate that the private lab that did the analysis had not properly handled the situation. Then, the letter stated "You may want to consider using the Wisconsin State Lab of Hygiene for future analysis because all results from there automatically go into our computerized data tracking system ...". This is not the only instance of attempting to switch customers to the State Lab that we have on file.

Last month many of our customers began bringing in copies of letters addressed to private water system users, informing them that they could have water tested free if they use the Wisconsin State Lab of Hygiene. This letter also informed them that they were free to have private labs perform the tests, but then they would have to file a report of results with the WIDNR. This letter is sent out annually to approximately 15,000 water systems - almost $250,00 of potential private business being directed to the State Lab.

On March 5 of this year our committee received a letter of complaint stating that a private lab in the Madison (WI) area was forced to reduce prices by being asked to bid against the WISLOH by the WIDNR. In this case, the WIDNR claims the bid went out in error and is not their normal policy.

On March 1, 1996, OMNI Associates, a private engineering consultant, wrote identical letters to a lab in central Wisconsin and a lab in the Fox River Valley of Wisconsin. The letters informed these two labs that they had been underbid by the University of Wisconsin Soils Lab.

In November of 1995, a State Lab staff member told the customer of a Milwaukee area lab that he had been overcharged by that lab and could have had the same analysis done by the WISLOH for almost 1/2 the price.

In November of 1995, in response to a complaint that it was offering a series of tests worth at least $125 for a mere $20, the University of Wisconsin-Stevens Point Chancellor indicated that they perform the number of tests necessary to meet the College's "educational, research and public service components". This, despite the fact that Stevens Point graduates working in the private sector claim the lab work is often done by English majors with work grants. A definition of its public service component was not given.

On a complaint that the University of Wisconsin-Stevens Point Aquatic Toxicology Lab underbid a private lab in the Madison area, the response was much the same.

Not only are we faced with the specific instances of competition, but new regulations are being promulgated by the agencies that steer business to the WISLOH. A recent example is the August, 1995, Chapter NR 845, relating to County Administration of Chapter NR 812, Private Well Code. In essence, this document advises counties to inspect 10% of noncommunity water systems and, at the request of the homeowner, collect well samples for bacteriological analysis as well as nitrate-nitrogen testing. Of

course, the samples are to be sent to the WISLOH where they will be tested at no cost to the county.

We need relief from this type of competition. Private laboratories can compete on a level playing field, but not when tax subsidized labs are offering tests at a fraction of their actual cost and bidding against the very laboratories that pay the taxes necessary to fund these competitive activities.

National Association of RV Parks & Campgrounds

July 16, 1996

The Honorable Jan Meyer
Chairman, Small Business Committee
US House of Representatives
Washington, DC 20515

Dear Madam Chairwoman:

The enclosed testimony is submitted for inclusion in the record of the hearings held on July 16, 1996 on the issue of government competition with private industry.

Mr. Ronald Brice, owner of Payson Campground, is one of the clearest victims of government competition and his story exemplifies the scope of the problem. I hope that his testimony will be included in the committee record and that the staff will consider his comments when evaluating the future legislative initiatives..

Thank you very much.

Sincerely,

David Gorin
President

8605 Westwood Center Drive ■ Suite 201 ■ Vienna, VA 22182-2231 ■ (703) 734-3000 ■ Fax (703) 734-3004
Outdoor Hospitality Excellence Through Industry Unity

PAYSON CAMPGROUND/MOGOLLON RIM RESORT
P O Box 2279, Payson, AZ 85547
FEDEX/UPS 808 EAST HWY 260 ZIP 85541
VOICE 520-474-8388 FAX 520-472-7214

BRIEF PRESENTED JUL 16, 1996

TO:

HOUSE COMMITTEE ON SMALL BUSINESS

BY

RONALD R. BRICE

APPEARING AS THE DAMAGED PARTY

ON BEHALF OF ARVC

(National Association of RV Parks and Campground Owners)

Honorable Jan Meyers, Chair, House Committee on Small Business;

Madam Chair and Members of the Committee:

The topic being addressed is the *NEW* United States Forest Service (USFS) Houston Mesa Campground (HMC) at Payson, AZ, in the Tonto National Forest.

Before constructing HMC, there were already 35 USFS campgrounds within 32 miles of Payson. Payson had 2 struggling Private RV Parks that had NEVER SHOWN A PROFIT, and my occupancy had never exceeded 20%. These two parks could not obtain locations where campers wanted to camp.....20 minutes east of Payson where temperatures are 15 degrees cooler (because it is all USFS land), and were struggling to survive financially. The USFS did not study occupancy in the nearby private sector, thereby violating sound business practices which resulted in the insensate expenditure of millions.

HMC was built at a cost exceeding $3,500,000 in an area where campers do not want to camp. The "per site" cost exceeds $25,000 when no private investor would consider spending more than $8,000 "per site" in this market. Then the facility was turned over to a private corporation for operation without consideration of land and construction costs (no investment required of this contractor). This contractor then promptly set his rates at less than 50% of my rates when my campground is only a few thousand yards away, thereby creating the ultimate in unfair competition.

My estimate of the USFS's return on investment for this facility is .00192% annually, based upon my expectations of HMC occupancy and rate of return in the concessionaire contract. This lack of financial responsibility is outrageous.

Before HMC, my business was valued at $1,450,000. I placed my property on the market in anticipation of the opening of HMC with full disclosure, and the highest offer I have had to date is $700,000.

Using outdated and inaccurate market figures, breaching sound business practices, violating at least 31 their own written directives in the Forest Service Manual (FSM), and violating 36 CFR CH II, section 219.21,b and 219.21,c, the USFS constructed HMC while openly admitting in the Environmental Assessment," In the beginning, the proposed HMC will probably compete with the private camping and RV facilities"..... and "The proposed HMC may directly impact the two campground/RV parks".....and "In conclusion, the proposed HMC could have an adverse effect on the private campgrounds and RV facilities currently in operation for the first few years that it is open." Many written admissions of knowledge of FSM 2303.11 which directs the USFS to not compete with the private sector are contained in my files. This blatant admission of intent to violate FSM 2303.11 and compete with the private sector is completely clear and is a matter of public record.

Prior to purchasing my property, uniformed USFS personnel at the Payson Ranger District hid the HMC project from me on two investigative inquiries. Prior to being granted my SBA loan, the Payson Ranger District misrepresented the HMC project to the certified appraiser doing the required appraisal for my SBA loan.

I believe I have the right as a taxpayer and businessman to expect the USFS to tell me the truth when I visit them personally, and further that my expectations that the USFS follow their own directives is a reasonable one. I counted on these two factors when I invested in my campground.

The USFS intentionally omitted the most significant unfavorable testimony in the Environmental Assessment for HMC because it would not have been justifiable to build HMC if this testimony was part of the record. The USFS intentionally stalled a meeting with myself and my attorney until the contract was signed to build HMC, then stated that they would be sued by the contractor if they did not build the facility.

MY SBA Loan is now threatened by the very Government that encouraged and backed my SBA Loan to stimulate private enterprise. The last three years, my business has grown at a rate of 20%. Up to the end of April 1996 (when HMC opened), my occupancy was up 18% over last year, right in line with our previous

growth. Since HMC opened, my business is down 21%, a 39% decrease in business since HMC opened. What is at risk is not just the loss of business, but my entire investment. I look forward to addressing this committee next year, should the occasion arise. By then, my campground will most likely be in bankruptcy, and my SBA Loan in default.

I am in possession of letters from the USFS where they lied to then Congressman KYL, and later Senator Kyl. One letter to the town states that, (paraphrased) "with HMC, Payson is now one step closer to being a destination rather than a place to pass through".....what about the two private parks who were here first, and have ample occupancy? Another letter to the town states that (paraphrased again) "Governments working together have provided a great place to camp" FSM 2303.10 states "do not provide facilities requested by local communities...."

I am tired of reading letters from the USFS where they quote from their FSM when it is convenient, and then ignore other directives when they want to unfairly compete. One letter stating that they would not compete with local stores, by selling firewood, but would compete with me (paraphrased again) really irritated me.

I have watched USFS officials from all levels ignore the truth when responding to Congressional and Senatorial inquiries. I have seen shameless waste of taxpayer

funds, and complete ignoring of their own written directives. I have witnessed the fact that the Tonto National Forest Supervisory Personnel are out of control. I believe ample evidence exists in my files to warrant a congressional investigation into the actions of the USFS, Tonto National Forest, concerning Houston Mesa Campground. Knowing what is in my files, I believe anything less than a complete investigation would be irresponsible to U.S. Taxpayers. I shall be happy to make my files available to a qualified investigator, and to offer my assistance.

Thank you for affording this opportunity for me to input facts to this committee, I should like to close with a quote from the FSM, 2330.3, POLICY which states: "..... Where it is not possible to achieve the objectives to the degree defined in this chapter, close sites and facilities to public use."
(go to appendix "A", see "chapter" violations)

I respectfully request this committee to recommend the immediate closing of Houston Mesa Campground, based upon this USFS FSM directive.

Respectfully submitted,

Ronald R. Brice
Owner, Payson Campground/Mogollon Rim Resort

encl: Appendix "A" ....list of FSM violations at HMC

APPENDIX A

LIST OF FOREST SERVICE MANUAL VIOLATIONS AT HOUSTON MESA CAMPGROUND, PAYSON, AZ, TONTO NATIONAL FOREST

2302,1

2303,1

2303,8

2303,9

2303,10

2303,11

2310.2,4

2310.3,5

2330.2,3

2330.3,2

2330.3,4

2330.3,5

2330.3,6,B

2330.3,6,C

2333.03,2

2333.03,3

2333.03,4,B

2330.03,4,C

2333.1,1

2333.1,3

2333.1,6

2333.43

2333.45

2333.51

2333.52

2334.03,3

23334.03,5

2334.21

2340.3,3

2340.3,4

36CFR CH II, section 219.21,B

36CFR CH II, section 219.21,C

Author's note: Agreeably, some of these "violations" may be argueable.....BUT ONLY A VERY FEW. The bulk of them are clear cut and undeniable violations of FSM Directives existing at Houston Mesa Campground which result in the most flagrant and documented case of unfair competition ever to exist in the camping industry.

LEWISTOWN PROPANE

The Home of Battery Warehouse

DENTON *L.P. GAS & FERTILIZER* STANFORD

P.O. BOX 88 PHONE 538-8791

LEWISTOWN, MONTANA 59457

August 1, 1996

Congresswoman Meyers
Chairperson House Small Business Committee
2303 Rayburn House
House Office Building
Washington, D.C. 20515-1603

Dear Congresswoman Meyers,

On July 18, 1996 I had the pleasure of addressing your committee. If you recall it was very busy that day. You were not present when my testimony was given.

My testimony was very important to me. It was about the non taxed farm co-ops competing against me in my business. I traveled almost 2000 miles to tell my story and felt that it was not heard by the committee. The other members of the panel had important testimony that they gave and I am not trying to take away anything from them, but my testimony is important also. If nothing is done about these co-ops in 20 years they will control our country. Every year they continue to buy more and more independent businesses and put them under the co-op shield. In our community there are more than eight farmer owned co-ops in direct competition against me. In turn these are run by bigger co-ops such as Cenex-Land-O-Lakes, Harvest States, Farmers Union and so on.

I respectfully request your review of my testimony and make it a matter of record of the committee.

Thank you for your time,

Gene Meier

Gene Meier

LP GAS
BOTTLED-TANK BULK PROPANE
THE MODERN FUEL

NCBA

STATEMENT OF RUSSELL C. NOTAR
PRESIDENT AND CEO
NATIONAL COOPERATIVE BUSINESS ASSOCIATION
TO THE
HOUSE COMMITTEE ON SMALL BUSINESS
HEARING ON UNFAIR GOVERNMENT AND NONPROFIT COMPETITION
ON
JULY 18, 1996

This statement is being submitted in response to the testimony of Gene Meier, representing the National Federation of Independent Business. The National Cooperative Business Association (NCBA), on behalf of America's cooperative business community, wishes to correct some of the inaccuracies in Mr. Meier's testimony. It is unfortunate that Mr. Meier views cooperatives as "the biggest threat to my professional career."

Mr. Meier is simply wrong in his assumption that the cooperatives with which his business competes do not pay the same taxes he must pay. Cooperatives pay taxes just as non-cooperative businesses do.

Cooperatives are businesses owned and controlled by the people who use them. Producers, consumers, and, yes, even small businesses like Mr. Meier's, join forces to market their products and purchase goods and services. The agricultural marketing and supply cooperatives that Mr. Meier addresses as his competition are not tax-exempt or non-profit or quasi-governmental. These cooperatives pay taxes under subchapter T of the tax code.

They pay taxes on income that is retained by the cooperative. Subchapter T does allow cooperatives to distribute patronage dividends to their members, but those members then pay taxes on that income. Patronage dividends represent that portion of the cooperative's net savings (income minus expenses) for the year, which are distributed to members based on the degree to which they patronized the cooperative that year. In this way, members of the cooperative receive back the excess amount of money the cooperative charged for its services.

Patronage dividends are adjustments to the price for services the cooperative rendered to the members. Since the cooperative only acts as an agent for the transactions, the cooperative need not pay tax on the price adjustment distributed back to the members. The members do pay tax on the patronage dividends received by them.

While these cooperatives are businesses engaged in trade for their members, they do not exist to maximize the capital holdings of the business itself; they are not capital-driven businesses. They are service-driven (they exist to market or purchase products for their members). As a result, they do not have the access to capital that other businesses have. Because cooperatives operate at cost, their only method of accumulating capital is through member contributions or retention of a portion of the members' patronage dividends.

Thus, cooperatives do pay taxes on earned income, both at the cooperative level and at the member level. Cooperatives pay all other taxes just the same as non-cooperative businesses. Cooperatives pay business income taxes, as non-cooperative businesses do, on all non-patronage sourced income. Cooperatives also pay property, payroll, and other taxes.

On behalf of the entire cooperative business community, I take great offense at Mr. Meier's red-baiting accusation that "co-ops are socialist." Cooperatives are businesses that operate within the capitalistic economy and are driven by market forces. The only difference is that a cooperative is owned by its members rather than by outside investors. Cooperatives are run by their members, not the government.

Cooperatives make sense for all types of enterprise. Interestingly enough, one of the fastest growing sectors of new cooperatives consists of small businesses forming larger entities (business purchasing cooperatives) to compete fairly with larger businesses. This type of organization was even endorsed by the magazine *Nation's Business* as an effective tool for small businesses to become better competitors. We would hope that NFIB would recognize this trend and work with us to further increase the power of small businesses in the marketplace. Indeed, we suspect that many of NFIB's members are already members of such purchasing cooperatives.

We would suggest that many cooperatives are, in fact, *small* businesses, just as the members of NFIB are. We continue to inform the public concerning the benefits of cooperation and our sponsorship of the Festival of America's Cooperatives on Capitol Hill in April of this year continued that effort with the U.S. Congress. Over 47,000 businesses in America are cooperatives with over 100 million members. We are pleased to be able to clarify several of these misunderstandings in Mr. Meier's testimony.

NCFC

NATIONAL COUNCIL OF FARMER COOPERATIVES

July 23, 1996

The Honorable Jan Meyers
Chair - House Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515

Dear Madam Chairwoman:

Last week, your Committee on Small Business held a hearing entitled "Unfair Government Competition with Small Business." At the hearing, farmer cooperatives were inaccurately characterized as unfair, non-profit competition to other small businesses. The facts of farmer cooperatives are simple -- farmer-owned cooperatives pay taxes -- in 1994, the "Top 100" farmer cooperatives paid $125 million in corporate income taxes, distributed stock dividends in the amount of $21.8 million, and distributed or allocated $727 million as patronage refunds, both of which are subject to taxation. This is in addition to the millions and millions of dollars in taxes paid by the individual farmers and owners who are the member-owners and patrons of farmer cooperatives.

Historically, this country enjoys three types of private business organizations: individually owned businesses, partnerships, and corporations. In the case of an "individually owned business," profits and losses are passed through to the owner and *no income taxes are paid at the business level.* The same is true with regard to a "partnership." However, "corporations" are different. In a corporation the profits are taxed as income to the corporation when earned, and as income to stockholders when distributed as dividends. Farmer cooperatives are generally organized as **Subchapter T corporations** and pay income taxes on all cooperative profits that are not distributed or allocated to members and patrons as patronage refunds.

It is important to note that cooperatives pay taxes like any other corporate entity. In fact, cooperatives pay under the same federal, state and local rules and regulations and at the same rates as other business organizations. They pay property taxes, sales taxes, excise taxes, school taxes and local taxes, and comply with the so-called burdens of regulatory compliance. Farmer cooperatives have not been singled out for special treatment; instead, they actively contribute to the societies in which they are located in a manner similar to other businesses. In my view and in the view of many communities across this country, America is better off because of farmer cooperatives.

It was my understanding the Small Business Committee Hearing on July 18th was to address "Unfair Government Competition with Small Business." I cannot imagine how anyone could characterize a farmer cooperative as government competition. Farmer cooperatives are private businesses which are farmer-owned and farmer-controlled.

50 F STREET, NW • SUITE 900 • WASHINGTON, DC • 20001 • 202-626-8700 • fax 202-626-8722

Serving America's Farmer-Owned Businesses

The Honorable Jan Meyers
July 23, 1996
Page two

Farmers who join together to form farmer cooperatives do so to enhance their economic interest and to help manage the inherent risk of production agriculture. As an example, a farmer's cooperative which buys and sells fertilizer and other agricultural inputs gives a patron or a member specific opportunities not otherwise available without the cooperative enterprise. Members of cooperatives want reliable goods and quality services, and reliable information about the goods and services. They want freedom from fraud and deception. Farmer cooperatives do not have the motivation or a reason to deceive themselves about the quality of goods and services they receive, since the cooperative is member owned and member controlled. In other words, farmer cooperatives do not engage in unfair competition, but fair business competition that fills a need not being filled by a different privately-held entity.

Additionally, farmer cooperatives are made up of individual business people, farmers and ranchers, who own small businesses like those you are working to assist in your Committee. Farmer cooperatives are locally owned by members of local communities where control does not come from some foreign entity, but rather, resides and is based in local communities where the voting control is spread among thousands of individual members.

I would like to meet with you and Members of your Committee to give you a better idea of the role and benefit of farmer cooperatives in America today. In any event, please enter this letter into the record of the July 18th hearing. If you have any questions or if I may be of any help to you in this matter, please do not hesitate to contact me at (202) 626-8700. I look forward to hearing from you.

Sincerely,

Wayne Boutwell

Wayne A. Boutwell
President
National Council of Farmer Cooperatives

cc: Members of the Small Business Committee
Members of the Ways and Means Committee

Enclosures: Farmer Cooperatives & Taxation
NCFC Fact Sheet
Testimony to Small Business Committee - July 18, 1996

NCFC

NATIONAL COUNCIL OF FARMER COOPERATIVES

FARMER COOPERATIVES & TAXATION

Farmer Cooperatives Pay Taxes: It is important to note that cooperatives pay taxes like all other corporate entities. In fact, cooperatives pay under the same federal, state and local rules and regulations and at the same rates as other business organizations. They pay property taxes, sales taxes, excise taxes, school taxes and local taxes, and comply with the so-called burdens of regulatory compliance. The facts of farmer cooperatives are simple -- farmer-owned cooperatives pay taxes -- in 1991, the "Top 100" farmer cooperatives paid $93.2 million in corporate income taxes, distributed stock dividends in the amount of $14 million, and distributed or allocated $633.7 million as patronage refunds which are subject to income taxes. This is in addition to the millions and millions of dollars in taxes paid by the individual farmers and owners, who are the member-owners and patrons of farmer cooperatives.

Business Structure Does Not Affect Tax Liability: Historically, this country enjoys three types of private business organizations: individually owned businesses, partnerships, and corporations. In the case of an "individually owned business," profits and losses are passed through to the owner and *no income taxes are paid at the business level.* The same is true with regard to a "partnership." However, "corporations" are different. In a corporation the profits are taxed as income to the corporation when earned and as income to stockholders when distributed as dividends. Farmer cooperatives are generally organized as **Subchapter T corporations** and pay income taxes on all cooperative profits that are not distributed or allocated to members and patrons as patronage refunds.

Farmer Cooperatives Cannot Be Construed as Government Competition: Farmer cooperatives do not receive favorable treatment from the Government. They are organized under state charters and operate under the same federal rules and guidelines as other business entities. Farmer cooperatives are private businesses which are farmer owned and farmer controlled.

Cooperatives Exist to Fill a Need Not Filled by Other Business: Farmers who join together to form farmer cooperatives do so to enhance their economic interest and to help manage the inherent risk of production agriculture. As an example, a farmer's cooperative which buys and sells fertilizer and other agricultural inputs allows a patron or a member specific opportunities not otherwise available without the cooperative. Members of cooperatives want reliable goods and quality services, and reliable information about the goods and services. They want freedom from fraud and deception. Farmer cooperatives do not have the motivation or the reason to deceive themselves about the quality of goods and services they receive, since the cooperative is member owned and member controlled. In other words, farmer cooperatives do not engage in unfair competition, but fair business competition that fills a need not being filled by a different privately-held entity.

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Serving America's Farmer-Owned Businesses

NCFC

NATIONAL COUNCIL OF FARMER COOPERATIVES

FACT SHEET

The National Council of Farmer Cooperatives is a nationwide association of cooperative businesses owned and controlled by farmers. Its membership includes nearly 80 major farmer marketing, supply, and credit cooperatives, plus 31 state councils of cooperatives.

NCFC members handle almost every type of agricultural commodity produced in the U.S., market these commodities domestically and abroad, and furnish production supplies and credit to their farmers' members and patrons.

The Council's members, in turn, represent more than 4,000 local cooperatives, with a combined membership that includes most of the nearly two million U.S. farmers.

Farmer Cooperatives & Agriculture — An American Success Story

- One in every three people in the U.S. belongs to one or more cooperatives. These cooperatives include farmer marketing, supply, and credit co-ops; rural utilities; credit unions; and housing, child care, and consumer co-ops.
- Farmer cooperatives market 86 percent of the nation's milk, 40 percent of all grains and oilseeds, 41 percent of cotton, 20 percent of fruits and vegetables, and 13 percent of the livestock produced in the U.S.
- With total sales of more than $90 billion, farmer cooperatives generate significant economic activity across many rural areas and communities.
- Nearly three million jobs are directly dependent on farmer cooperatives with most located in rural areas and communities. These, in turn, support another 20 million jobs throughout the U.S. economy.
- Agriculture represents a leading export industry with exports well over $60 billion. Without agriculture's positive trade balance of over $30 billion, the U.S. trade deficit would be even larger.
- As an industry, agriculture represents one of America's great success stories. Today, one American farmer produces enough food and fiber to meet the needs of 129 people.

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Serving America's Farmer-Owned Businesses

Hello, Madam Chair, Members of The Committee, I would like to thank you for the opportunity to speak to you today. My name is Gene Meier. I own and operate Lewistown Propane and Fertilizer in Lewistown, Montana. I have twelve employees and have been in business twenty-two years. during that entire time, I have been a member of the National Federation of Independent Business (NFIB).

NFIB is the nation's largest small business advocacy organization, representing more than 600,000 small and independent business owners across the United States. For more than half a century, NFIB has served the needs of small business on a broad spectrum of issues. NFIB sets positions on matters of public policy by a regular polling of the membership.

It is fitting that I have been asked to address this committee today regarding the matter of non-profit competition. The biggest threat to my professional career is the unfair cumpetition of rural cooperatives. These co-ops are tax-exempt, quasi-government entities. They pay no State or Federal income tax because they are advertised as "Customer Owned" or "Where the Customer is the Company." While they do pay some county taxes they are only a fraction of what my company pays. A so-called "benefit" they advertise is that they are a 'non-profit" company. Why should a non-profit business be allowed to compete with real profit oriented tax paying enterprises? I know I can't continue to compete on this unequal playing field.

In the county where I live, there are eight farmers' co-ops competing against me. In that same area there are only two independent businessmen. Twenty years ago these numbers were reversed. The trend is for more non-profits to come into being -- not more

businesses! With no taxes they can sell at lower prices until they are well established and I will be out of business

Twenty-two years ago when my father brought me into the business, the local Cenex Cooperative decided to take their market share in the propane business. This was followed by five years of below cost propane. It was not good for anyone. We barely survived. We paid very few taxes because we made little money. As soon as they gained a share, their prices rose to meet ours. My question again is how can a non-profit company be allowed to compete?

We are a Capitalist society, Co-ops are Socialist. This must change if any tax paying independent businesses are to remain. Cooperatives are in every part of our economy; agriculture, communications, transportation, insurance, computers, groceries, convenience stores, and the list goes on and on. The only thing you have to do to become a patron of a cooperative is to purchase just one item. In gasoline stations many times people only do one or two purchases and never return. I am sure they never receive a patron dividend.

Farmer-owned cooperatives seem to be sacred. Many have told me this could cost me my business because I am speaking out against the farming industry. Actually, the opposite has happened. I have had many people come into my business and express their support. They also feel if you are in business you should pay taxes equal to everyone else in the community.

One major recommendation of the White House Conference on Small Business was to get non-profit, non-taxed business out of competition with legitimate business. This is

also a high priority for the National Federal of Independent Business. I am sure everyone is aware of the impact independent businesses have on our nation's economy. If our government chooses to follow the agenda of the National Federal of Independent Business, we will all benefit.

In closing, I don't want to destroy any businesses, just make it equal across the board for all businesses. I would like Congress to level the playing field. Make every business a profit-oriented, tax paying business. If they can't compete by paying on the same tax base and running with a profit, they shouldn't be in business.

I appreciate your taking time to hear my concerns and I would be pleased to take any questions you might have.

EARLY CHILDHOOD DEVELOPMENT CENTER LEGISLATIVE COALITION

3612 Bent Branch Court
Falls Church, VA 22041
(703) 941- 4329

Dr. William J. Tobin
Executive Director

July 12, 1996

The Honorable Jan Meyers
Chairwoman
House Committee on Small Business
2361 Rayburn House Building
Washington, DC 20515-6315

Dear Chairwoman Meyers:

I am writing on behalf of the approximately 65,000 tax-paying, private, licensed early childhood development centers nationwide. The overwhelming majority of these centers are true small businesses caring for an average of 75 preschoolers with a total staff of 10 providrs and assistants. I request that this comment letter be included as part of the hearing record.

First, let me commend you and the Committee Members for scheduling two days of hearings on the very real and economically devastating issue of unfair competition which these centers have experienced from both government entities and tax-exempt organizations. These hearings are long overdue and presumably will update the ongoing record from previous hearings before the Committee and the Committee on Ways and Means over the last decade.

Second, we wholeheartedly endorse the position adopted by the Business Coalition for Fair Competition, the recommendation on this issue emanating from the 1995 White House Conference on Small Business, and H.R. 28, "The Freedom From Government Competition Act" introduced by Representative Duncan and a companion measure, S. 1724.

Let me provide some examples of how both governmental entities at all levels and tax-exempt organizations unfairly impact the economic competitiveness of our tax-paying small businesses.

Nationally, regulations in effect through the U.S. Department of Agriculture regarding participation of private licensed child care centers in the Child and Adult Care Food Program have had a ten-year effect of excluding over 3 million youngsters annually from receiving fully or partially subsidized food and snacks. Children attending tax-exempt and religious centers and family day care programs automatically have qualified for subsidies.

On the State and local level, frequently rules and regulations have been adopted that exclude tax-paying, private centers from bidding for contracts or participating in publicly funded programs. An example of this is the favored status of local Parks and Recreation Authorities to conduct Summer care programs while private centers are excluded from bidding to provide similar services.

Apparently, there continues to be present a mentality that tax-paying, private centers somnehow cater only to the children of the wealthy or bend the rules on safety and health in order to maximize the return to those who support the private centers with their investment decisions.

Regarding unfair competition in child care from tax-exempt organizations there are many examples. For instance, in many communities, contracts to conduct after-school or school-age child care programs routinely are awrarded to such groups as the YMCA because tax-paying private programs are excluded from the bidding process. The requirements often are that such contracts are limited to "community-based, non-profit organizations." The tax-exempt organizations also can demonstrate lower operating costs because they are permitted to go on-site into public schools where the facility and utility costs are nil. Oftentimes, a tax-paying small business child care center is nearby in the neighborhood and the children could easily walk or be transported to those centers.

Another example identified in recent years was the new Golden Triangle YMCA in Pittsburg which not only established with tax-payer subsidies an executive-type health and fitness club but also devoted significant space to conduct child care programs after a careful market study of the prevailing local private rates.

All our centers request is the right and opportunity to compete on a fair level.

What are possible solutions? Regarding government-related competition, adopt measures and regulations across the board that will prohibit such economically harmful practices and/or require the inclusion of taxpaying small businesses in any competitive situations (after appropriate economic adjustments have been made to exclude from the comparison base the tax and other advantages enjoyed by governmental entities).

Regarding unfair competition from tax-exempt entities (including hospitals and universities), either require the tax-exempt organizations to demonstrate that they are providing subsidies to families commensurate with the low-income economic profile of the neighborhood or nearby area (certainly not the SMSA) and that the value of this subsidy represents a reasonable percentage value of the savings they receive due to their tax-exempt status, and/or require the tax-exempt organization to pay unrelated business income tax whenever they engage in commercial-like, competitive programs with the private sector. (It should be noted that relying solely on the stated purpose of the tax-exempt organization as the sole criterion for determining commerciality often is not sufficient since some of these "purposes" are so-broadly stated that almost anything they do conceivably could be subsumed under that declaration).

Finally, we also wholeheartedly endorse the arguments and recommendations made in two books authored by Professors James T. Bennett (George Mason University) and Thomas J. DiLorenzo (Loyola College in Baltimore), Unfair Competition: The Profits of Nonprofits, (Lanham/New York: Hamilton Press, 1989), and Unhealthy Charities: Hazardous To Your Health and Wealth, New York: BasicBooks, 1994).

Thank you again, Chairwoman Meyers and Members of the Committee for conducting these important and long-overdue hearings. We stand ready

to work with you to ensure the future service availability, and economic stability of our tax=paying, early childhood small businesses. In this age of welfare reform where more than ever there will be needed a growing array of child care options, something must be done to ensure a level, fair playing field for the private, licensed child sector.

Cordially,

William J. Tobin

Dr. William J. Tobin
Executive Dirctor

EARLY CHILDHOOD DEVELOPMENT CENTER LEGISLATIVE COALITION

3612 Bent Branch Court
Falls Church, VA 22041
(703) 941-4329

Dr. William J. Tobin
Executive Director

STATEMENT SUBMITTED ON BEHALF OF
EARLY CHILDHOOD DEVELOPMENT CENTER LEGISLATIVE COALITION
TO HOUSE COMMITTEE ON SMALL BUSINESS
REGARDING HEARINGS ON UNFAIR COMPETITION EXPERIENCED BY
SMALL BUSINESSES FROM GOVERNMENT AND TAX-EXEMPT ORGANIZATIONS
July 16 and 18, 1996
by DR. WILLIAM J. TOBIN, EXECUTIVE DIRECTOR

Chairwoman Meyers and Members of the Committee. This statement is offered on behalf of the approximately 65,000 tax-paying, private, licensed early childhood development centers nationwide. The overwhelming majority of these centers are true small businesses caring for an average of 75 preschoolers with a total staff of 10 providers and assistants. I request that this statement be included as part of the record for the hearings being held on July 16 and 18, 1996.

First, let me commend you and the Committee Members for scheduling hearings on the very real and economically devastating issue of unfair competition which these centers have experienced from both government entities and tax-exempt organizations. These hearings are long overdue and presumably will update the ongoing record from previous hearings before the Committee.

Second, we wholeheartedly endorse the position adopted by the Business Coalition for Fair Competition, the recommendation on this issue emanating from the 1995 White House Conference on Small Business, and H.R. 28/ S. 1724, "The Freedom From Government Competition Act."

Let me provide some examples of how both governmental entities at all levels and tax-exempt organizations unfairly impact the economic competitiveness of our tax-paying small businesses.

Regarding unfair competition <u>resulting from actions of governmental entities</u>, national regulations in effect through the U.S. Department of Agriculture concerning participation of private licensed child care centers in the Child and Adult Care Food Program have had a ten-year effect of excluding over 3 million youngsters annually from receiving fully or partially subsidized food and snacks. Children attending tax-exempt and religious centers and family day care programs <u>automatically</u> have qualified for subsidies.

On the State and local level, frequently rules and regulations have been adopted that exclude tax-paying, private centers from bidding for contracts or participating in publicly funded programs. An example of this is the favored status of local Parks and Recreation Authorities to conduct Summer care programs, while private centers are excluded from bidding to provide similar services.

There also is the growing problem of the unwarranted expansion of Pre-Kindergarten (PRE-K) early childhood programs by the public schools nationwide which compete directly and unfairly with licensed private and religious childcare centers. Not only are the States and localities

using the taxes our members pay literally to help put them out of business by capturing the market for 3 and 4 year olds, but these publicly funded programs within the public school setting actually have been found in the only comprehensive study ever undertaken to be psychologically and pedagogically unsound for the children (Cf. Anne Mitchell, Michelle Seligson and Fern Marx, Early Childhood Programs and the Public Schools: Between Promise and Practice, (Dover, Md.: Auburn House Publishing Co., 1989, and appended Poisition Paper, "Pre-K In The Public Schools: A Dangerous Public Policy"). During the last period for which data is available (1991-2), 32 States had invested $667 MILLION annually for various PreK initiatives.

Apparently, there continues to be present a mentality that tax-paying, private centers somnehow cater only to the children of the wealthy or bend the rules on safety and health in order to maximize the return to those who support the private centers with their investment decisions.

Regarding unfair competition in child care from tax-exempt organizations there are many examples. For instance, in many communities, contracts to conduct after-school or school-age child care programs routinely are awrarded to such groups as the YMCA because tax-paying private programs are excluded from the bidding process. The requirements often are that such contracts are limited to "community-based, non-profit organizations." The tax-exempt organizations also can demonstrate lower operating costs because they are permitted to go on-site into public schools where the facility and utility costs are nil. Oftentimes, a tax-paying small business child care center is nearby in the neighborhood and the children could easily walk or be transported to those centers.

Another example identified in recent years was the recently built Golden Triangle YMCA in Pittsburg which was not only established with tax-payer subsidies as an executive-type health and fitness club but also devoted significant space to conduct child care programs after a careful market study of the prevailing local private rates.

All our centers request is the right and opportunity to compete on a fair level.

What are possible solutions? Regarding government-related competition, adopt measures and regulations across the board that will prohibit such economically harmful practices and/or require the inclusion of taxpaying small businesses in any competitive situations (after appropriate economic adjustments have been made to exclude from the comparison base the tax and other advantages enjoyed by governmental entities).

Regarding unfair competition from tax-exempt entities (including hospitals and universities), either require the tax-exempt organizations to demonstrate that they are providing subsidies to families commensurate with the low-income economic profile of the neighborhood or nearby area (certainly not the SMSA) and that the value of this subsidy represents a reasonable percentage value of the savings they receive due to their tax-exempt status, and/or require the tax-exempt organization to pay

unrelated business income tax whenever they engage in commercial-like, competitive programs with the private sector. (It should be noted that relying solely on the stated purpose of the tax-exempt organization as the sole criterion for determining commerciality often is not sufficient since some of these "purposes" are so-broadly stated that almost anything they do conceivably could be subsumed under that declaration).

Finally, we also wholeheartedly endorse the arguments and recommendations made in two books authored by Professors James T. Bennett (George Mason University) and Thomas J. DiLorenzo (Loyola College in Baltimore), Unfair Competition: The Profits of Nonprofits, (Lanham/New York: Hamilton Press, 1989), and Unhealthy Charities: Hazardous To Your Health and Wealth, New York: BasicBooks, 1994).

Thank you again, Chairwoman Meyers and Members of the Committee for conducting these important and long-overdue hearings. We stand ready to work with you to ensure the future service availability, and economic stability of our tax=paying, early childhood small businesses. In this age of welfare reform where more than ever there will be needed a growing array of child care options, something must be done to ensure a level, fair playing field for the private, licensed child care sector.

WILLIAM J. TOBIN AND ASSOCIATES

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PRE-K IN THE PUBLIC SCHOOLS: A DANGEROUS PUBLIC POLICY

by
Dr. William J. Tobin

A late 1994 study issued by the Children's Defense Fund, First Steps, Promising Futures: State Prekindergarten Initiatives In The Early 1990s, reported that during 1991-2, 32 States had invested $667 Million in various Pre-K initiatives predominantly conducted through Public School Districts (a summary of the highest State expenditures is appended). Much of this funding came from State resources, but a review and analysis by this author of the recent State Plans and State Applications for the Child Care and Development Block Grant (CCDBG) has shown that several States (e.g., CT, FL, IL, KS, KY, LA, MI, MN, NJ, OR, PA, SC, TN, VA) currently are using part of those Federal funds to start or expand Pre-K programs in the Public Schools, and most of these and other States use Block Grant funds to help expand Head Start programs.

This is a very harmful trend and questionable public policy for several reasons.

The only known large-scale study of the effectiveness of Public School Pre-K programs was conducted by Anne Mitchell, Michelle Seligson, and Fern Marx and reported in their study, Early Childhood Programs and The Public Schools: Between Promise and Practice, (Dover, MA: Auburn House Publishing Co., 1989). Their study was nationwide and encompassed three phases: a State Survey of administrative policies; a District Survey of 1225 Public School Districts; and Case Studies in-depth of 13 school districts in 12 States. In summary, they gave the Public-School Pre-K programs failing grades [reported in a summary article in Young Children, (September, 1989), p. 60]:

> Clearly, all the cautions and 'only-ifs' voiced by early childhood professionals have not been heeded. Nationwide, the situation is that public school prekindergartens are:
>
> ° doing fairly well on the mechanics of quality group size and staffing ratios;
> ° not doing so well on teacher preparation, program content, or multi-cultural sensitivity;
> ° not commonly providing comprehensive services;
> ° not involving parents as much as they could;
> ° not meeing parents' needs for full-working day, year-round services;
> ° not subject to the same regulatory standards as other programs for young children;
> ° not drawing funds away from the rest of the early childhood system, but are in some cases drawing away qualified teachers and creating competition for space and children.

Among additional concerns are the safety and health of young children particularly in urban, inner-city public school settings, and the fact that public-school based early childhood programs fall outside the licensing, regulatory and monitoring systems of the States, ensuring basic health and safety.

However, the principal arguments against the public policy of expanding Pre-K Public School-based programs are economic, psychological, and pedagogical.

a) Economic Argument: First of all, in many instances, Public School-based programs can be much more expensive to conduct because of higher teacher salaries and other operational costs. Even though parent fees may not be higher, the public subsidy for the programs can result in a significant drawdown of already limited subsidy resources for other parents.

Secondly, private and religious centers which provide services for infants through 4-year olds tend to average parent fees over the range of children and families. In other words, due to the labor intensity of the services, they make money from 4-year olds and lose it on infants and toddlers. When they lose access to serving a large pool of 4-year olds, they are forced to charge the actual rates for infant/toddler care which frequently is beyond the means of the parents (who, in turn, are forced to seek other, usually unlicensed, family daycare arrangements). As a result, the centers cease offering much-needed infant/toddler care, and in some instances, are forced to go out of business.

Moreover, there is the unfair competition argument, namely, that it is blatantly unfair and unjust to use the tax dollars from private, tax-paying centers to start or expand a system that will put them out of existence (thereby, also, contributing to a reduction in availability of child care spaces). Nor is it valid to argue that in some locales Public School Districts may allow other providers to seek contracts to conduct Pre-K programs since in most instances local regulations prohibit for-profit and religious groups from competing.

b) Psychological Argument: Many early childhood developmental pysychologists have voiced concerns about placing 3 and 4-year old children in the formalized structures of Public Schools. They argue that this may result in short- and long-term emotional stress for the young children. As Dr. David Elkind, former President of the Naional Association for the Education of Young Children, has written (Phi Dela Kappan, [May 1988]):

> What harm is there in exposing young children to formal instruction involving the inculcation of symbolic rules? The harm comes from what I have called 'miseducation'...The short-term risks derive from the stress wih all its attendant symptoms that formal instruction places on children; the long-term risks are of at least three kinds: motivational, intellectual, and social. (emphasis added)

c) Pedagogical Argument: The more objectivized learning methodologies employed in formal education may be inappropriate for the learning modes for young children which should be based on learning and discovering through play. As Dr. David Weikart observed (Ford Founda-

tion Project on Social Welfare, 1989):

> With the arrival of state funding, some schools are planning to foist formal academic standards on young children. Usually, school curricula involve direct instruction in reading, writing, and arithmatic...The public schools need considerable guidance and training to learn new ways of thinking about young children in terms of their developmental needs. (emphasis added)

Additionally, it should be recalled that during the Congressional debate in 1989-90 on a modified (later rejected) "ABC Bill" which would have earmarked over $425 Million annually for Public School early childhood programs, similar reasoning prevailed and the provision was removed from the bill. What was evident at that time, seems to be valid now--this can also be viewed as an attempt by the leadership of organized Public School teacher unions to seize a role in an area where up to recent years they had not been, namely, early childhood education, and thereby, reduce or eliminate 85% of the early childhood, centerbased community -- the private and religious sectors.

Finally, when it is said that there are waiting lists for childcare in various States, this should properly be understood as indicating that the current Federal and State subsidy funding for eligible, low-income families is insufficient, not that spaces in childcare centers are lacking. Rather, a recent survey in 6 States of the current vacancies in centers has revealed vacancies ranging from 15-28%. Many owners/directors of centers have stated that they readily would expand their infant/toddler programs if only they could fill their vacancies for 3 and 4-year olds. In certain geographic areas, infant and toddler care may be in short supply, but this can be alleviated in other ways, and few advocates seem aware of the massive recent Federal increases in the Earned Income Tax Credit program ($36 Billion increase over an 8-year period) which also can be used by low-income parents for childcare expenses.

APPENDIX

Examples of 1991-2 State expenditures for Public School Pre-K Programs:

STATE	EXPENDITURES (Millions)	EST. # CHILDREN SERVED
CA	$ 83	35,200
FL	$ 69	30,000
IL	$ 71	29,485
KY	$ 31	12,000
MI	$ 33	13,094
NY	$ 52	19,600
OK	$ 2	1,814
TX	$144	80,000
WA	$ 19	6,000

(Source: Children's Defense Fund, First Seps, Promising Futures, Pages 23-4, Table 1-2)

ASTA

July 16, 1996

The Honorable Jan Meyers
Chair, House Small Business Committee
Rayburn House Office Building
Washington, D.C. 20514

Dear Madame Chair:

The travel and tourism industry applauds your efforts in holding hearings regarding the unfair competition small businesses experience from tax-exempt organizations and the U.S. government. As you know, this issue was among the top 15 recommendations identified by the delegates at the 1995 White House Conference on Small Business.

Unfair competition from nonprofit and federally funded organizations who engage in the commercial activities of selling travel and tours has plagued our industry for decades and continues to expand and thrive at an astounding rate. A group of approximately thirty museums, universities and other tax-exempt travel providers have gone so far to retain the firm of Coopers & Lybrand to submit a proposed Revenue Procedure to the Internal Revenue Service (IRS) outlining safe harbors for the non-taxability of the business income derived from such activities.

Several of us who represent the for-profit sector of the travel and tourism industry (the American Bus Association, the American Hotel and Motel Association, the American Society of Travel Agents, the National Tour Association, and the United Motorcoach Association) have banded together to present what in our view is a constructive regulatory framework for providing true guidance on the sale of travel related services by tax-exempt organizations. This paper, entitled "True Guidance for Tax-Exempt Travel and Tours," was prepared by the Argus Group on December 22, 1995 and submitted to the IRS. A copy is attached and we would appreciate your making it a part of the hearing record.

Madame Chair, we thank you for your time and dedication in this matter. Please find attached a list of the travel and tourism industry representatives who have endorsed this letter.

Sincerely,

Barbara E. O'Hara

Barbara E. O'Hara
Director
Government Affairs

Attachments

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ARGUSGROUP
Law, Public Policy and Economics

December 22, 1995

Mr. Marcus Owens
Director
Exempt Organizations Technical Division
Internal Revenue Service
Room 6411
1111 Constitution Ave., NW
Washington, DC 20224

Re: Travel and Tour Operations by Tax-Exempt Entities

Dear Mr. Owens:

Enclosed please find the comments of the Business Coalition for Fair Competition (BCFC) in connection with the issue of guidance for tax-exempt entities that operate travel and tour services. The BCFC is a coalition of businesses and trade associations that has taken a strong interest in the unrelated business income tax (UBIT) and other issues involving unfair competition by tax-exempt and governmental entities since the mid-1980s. The comment letter was prepared by the Argus Group for the BCFC which wrote to you on October 11, 1995 indicating that these comments would be forthcoming.

The BCFC comment letter urges the Service not to create a revenue procedure along the contours of the proposal submitted to you by Coopers & Lybrand (C&L). The C&L proposal is unworkable in several respects. First, it is inconsistent with present guidance and with the underlying law and regulations. Second, it simply does not provide practical guidance to either the tax-exempt community or the Service as they try to comply with or administer the law. Third, if adopted, it would dramatically enlarge the scope of tax-exempt commercial activities in a way totally unwarranted by the law or sound public policy. Fourth, it would reduce federal revenues considerably at a time when it is wholly inappropriate to do so. Fifth, a revenue procedure is the wrong mechanism to provide substantive guidance of the type C&L proposes.

The enclosed BCFC comment letter provides what we view as a constructive regulatory framework for providing true guidance. The draft regulation set forth in the comment letter would provide factors that conclusively determine that a travel and tour activity is substantially related to the providing entities' exempt purpose; factors that

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conclusively determine that a travel and tour activity is not substantially related to the exempt purpose; and factors that should be weighed in the absence of a conclusive determination.

The BCFC strongly believes that such regulatory guidance should be subject to notice and public comment.

By all measures, there has been extraordinary growth in unfair competition by the commercial arms of tax-exempt entities. A leading recommendation of the White House Conference on Small Business was to address the unfair competition issue more aggressively. The unrelated business income tax was enacted to prevent unfair competition. Regulatory guidance should provide practical guidance to taxpayers and revenue agents, be consistent with underlying purpose of the statute and protect federal revenues. The proposed BCFC guidance achieves all three . The proposed C&L guidance achieves none.

We look forward to working with you and your colleagues as you work to provide true guidance on this issue.

Sincerely

Dan R. Mastromarco
Partner

David R. Burton
Partner

ARGUSGROUP
Law, Public Policy and Economics

True Guidance for Tax-Exempt Travel and Tours

Towards a Better Understanding of the Policy, Economic and Legal Issues

December 22, 1995

317 Massachusetts Ave., NE • Suite 201
Washington DC 20002
Tel: 202 543 4444 • Fax 202 546 4444

Executive Summary

Coopers and Lybrand (C&L), on behalf of approximately thirty museums. universities and other Internal Revenue Code (IRC) Section 501(c)(3) travel providers and tour operators, have submitted a proposed Revenue Procedure to the Internal Revenue Service (Service) outlining safe harbors for the non-taxability of the business income derived from such activities (See Appendix I). The nonprofit coalition's proposal is intended to alleviate audit burdens they are experiencing, and ostensibly to clarify the circumstances under which commercial travel and tour searches will be exempt from tax as "substantially related" to the exempt educational function.

The Business Coalition for Fair Competition (BCFC), an organization whose membership consists of the American Bus Association, the American Society of Travel Agents, the National Tour Association, the United Bus Owners Association and other for-profit travel and tour providers, [1] understands the Service is seeking to respond to these concerns by developing guidance on the proper treatment of nonprofit travel and tour promotion activities in the educational context. In addition, we understand the Service is considering the C&L proposed guidelines as a blueprint for a revenue procedure.

In exercising its discretion to develop this guidance, the BCFC believes it important, indeed critical, that the Service seriously consider technical and practical input from the affected business communities. These comments are provided as an preliminary means to provide input during your rulemaking process.

In summary, the BCFC believes that the C&L "guidance", if adopted, would be fraught with problems from a definitional, enforcement, policy and revenue perspective. First, the proposed guidance would fail to measure up to its own standards, by clouding, not clarifying, the standards for distinguishing substantially related from unrelated activity. Not only will the proposal inserts new and more liberal tests for what is and is not substantially related, but the proposal is fashioned in such a way that the responsibility for justifying the causal linkage between the activity and the exemption is delegated almost exclusively to the nonprofit on a subjective basis.

Second, when the proposal does provide objective criteria, it interjects new considerations that unjustifiably broaden established contours for related activities -- standards that are too liberal at the outset. Indeed, the C&L proposal would have the Service entertain standards for complete exemption from tax that are so liberal and so ill-defined, and so unenforceable, that they would not be remotely considered for purposes of determining the deductibility of items of for-profit expense -- including the charitable contributions or deductions for business travel.

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[1] Section 7.01(7) of the Revenue Procedure 89-14, encourages all interested parties to submit suggestions of generic issues that would be appropriately addressed in revenue procedures and revenue rulings.

Third, BCFC believes that the proposal's exclusive focus is misdirected towards defining a safe-harbor for nonprofits. The proposed guidance would significantly increase the level and breadth of unfair competition. Thus the proposal would exacerbate the very problem the unrelated business income tax was designed to prevent, without recommending administerable guidelines on what activities are taxable. This enlargement of the exemption would fail to add clarity, and it would also occur at a time when the Service is experiencing increased revenues from recalcitrant nonprofits, and when small business complaints about unfair competition has reached an audible pitch.

Fourth, if adopted, the proposal would fail to take into consideration serious tax expenditure effects of the safe harbor. These expenditure effects are appropriate considerations, as you know, in drafting rulemakings. Here, the revenue foregone effects of these changes are not insignificant, and are not justifiable on policy grounds.

Finally, a revenue procedure may not be the appropriate vehicle with which to resolve these questions of substantive law. Not only is the proposed guidance substantive in nature, but it is on a subject so controversial that notice and comment is essential.

BCFC believes the rule cannot produce clarity by liberalizing current law, but rather only by delineating factors that the Service will review, and the standards by which it will review those factors, in order to definitively establish taxability. Secondarily, the rule can add clarity by enunciating the criteria that, if present, would definitively cause the activity to be considered substantially related. The rule should then seek to promote compliance and administerability for numerous factual patterns which fall in the gray area by providing for a rebuttable presumption of taxability, and then by positing those factors that will rebut or substantiate the presumption. We also believe the rule should provide specific examples of these principals by setting forth exemplary fact patterns and determinations.

Additionally, BCFC maintains that in order to address the full gamut of the issues affecting nonprofit travel and tour services, the rulemaking should also encompass important issues concerning allocation of expenses and overhead. Moreover, the rulemaking should not merely focus on universities, but on the many other nonprofits including social clubs, museums and membership organizations that base exemption from taxation on other premises.

As a related procedural point, in order to efficiently focus enforcement resources and guidance, BCFC believes the rulemaking ought to address the most egregious areas of unfair competition by seeking suggestions of factual scenarios from the small business sector. For example, while the Service appears to be focusing exclusively on colleges and universities, for-profits are also experiencing unfair competition from such venerable groups as the Smithsonian Institution, the National Institute for Historic Preservation, churches and others. BCFC would be more than pleased to provide the Service with representative examples of unfair competition; and conversely, examples where unfair

competition does not exist. Indeed, perhaps the ruling can establish a format for logging such complaints so that they might be dealt with in a systematic manner.[2]

We offer for your consideration an alternative proposal. Our proposal, appended as Exhibit II, will advance the objective of clarification, preserve the fundamental underpinnings of the UBIT and current guidance, and prevent the activity from unfairly competing with for-profit suppliers.

This document is being submitted because of the importance of the issues presented and in the hope that the Service will incorporate these suggestions into its guidance for better enforcement of the UBIT.

[2] In addition, however, the Service should rely upon data provided by the 1988 revisions to the Form 990 and by audits to help identify specific areas of nonprofit activity with considerable overlap with the private sector. Such overlap can occur in markets as defined not only by the customer base but also by the locale served and the mode of transportation. These and other recommendations are discussed in greater detail below.

I. The Perspectives of the Nonprofit and For-Profit Communities

A. The Context of the Dispute

The twin issues that confront the Service: the proper level of enforcement resources and the appropriate definition of the 'substantially related' test cannot be viewed in isolation. but must be placed in the context of an important ongoing debate. The taxability of travel and tour promotions, as with other commercial activity of nonprofits, is part of a public discussion which began more than one-half century ago with the enactment of the UBIT.[3] The purpose of the UBIT was to define the parameters of acceptable nonprofit activity deserving the highest incentive the tax code can provide -- full exemption.

Today, dissatisfaction over the lack of effectiveness of the UBIT in arresting unfair competition is simmering on the small business tax policy agenda. Rapid growth in the number of nonprofits and their vast asset holdings coupled with their increasing focus on commerciai activity, have caused renewed concerns, particularly for smaller firms.[4] The crux of the business community's concern centers around the inadequacy the "substantially related" test, and they have repeatedly voiced these concerns.

In 1984, for example the Office of the Chief Counsel for Advocacy of the U.S. Small Business Administration, produced a key report on unfair competition by nonprofit organizations.[5] According to that report:

> *The issue of competition by nonprofit with small business is part of the much larger problem of government competition with the private sector. To the extent that the Federal government subsidizes nonprofit organization activity through the corporate income tax exemption in the Internal Revenue Code, nonprofit activity represents a form of indirect government competition*[6].

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[3] And perhaps even before that. In colonial America the Massachusetts Bay Province Laws of 1706-1707 provided exemption from local property and poll taxes for fellows and students of Harvard. Most other educational institutions were exempt. See Alfred Balk, the Free List 22-23 (1971); Columbo, John D., Why is Harvard Tax Exempt? (And Other Mysteries of Tax Exemption for Private Educational Institutions), 35 Arizona law Review 860.

[4] All told, the estimated 1.2 million organizations in the tax exempt sector have an estimated $1 trillion in assets. Overall figures are necessarily rough approximations since Churches do not file returns. According to IRS Statistics of Income Bulletin, Summer 1994, pp. 81-88, the revenues of tax-exempt organizations was 9.9 percent of the U.S. gross domestic product in 1990 up from 5.7 percent in 1975. Assets increased in *real* terms by 150 percent over than period and revenues increased by 227 percent.

[5] Uniform Competition by Nonprofit Organizations with Small Business: An Issue for the 1980s (June 1984, Third Edition). See also, U.S. SBA, Government Competition: A Threat to Small Business (1980). This was the report of the SBA Advocacy Task Force on Government Competition with Small Business.

[6] Id. at p. 1.

tour operators face competition by nonprofit organizations supported in whole or part by public funds. Because the operations of nonprofits are subsidized through Federal and state tax exemption and other benefits, they are frequently able to price tours lower than private competitors.[7]

Beginning in 1987, the Congress undertook comprehensive examination of non-profit business activity.[8] In announcing these hearings, Chairman Rostenkowski stated the purposes of the hearings thusly:

With limited exceptions, there has been no comprehensive review of the unrelated business income tax rules since 1969. Since that time there has been substantial growth in the tax-exempt sector of our economy.... In recent years, exempt organizations have become more aggressive in undertaking commercial or entrepreneurial activities. For-profit businesses have complained that tax-exempt organizations have become more aggressive in undertaking commercial or entrepreneurial activities. ... Indeed, the is issue of unfair competitive advantage has now reached national prominence as designated by the demonstration of this issue as priority items during the recent National White House Conference on Small Business.

At these hearings, more than 300 witnesses testified, generating more than 2,300 pages of hearing record over five days.

On March 31, 1988, the Ways and Means Committee again considered the issue, this time in the context of specific discussion options, on which the Committee solicited public comment. In those discussion options, the Committee had recommended:

Apply[ing] UBIT to travel and tour services (with exception for services provided by colleges/universities to students/faculty as part of a degree program curriculum and de minim sales to non-students/faculty.

In the draft report describing recommendations on the UBIT of June 23, 1988, then Chairman Pickle of the Subcommittee on Oversight, Ways and Means Committee, determined that:

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[7] Id at p. 19.

[8] On September 12, 1986, the House Ways and Means Committee announced hearings to review the tax treatment of commercial activities of exempt organizations (Committee on Way and Means, U.S. House of Representative, Press Release Number 25 (September 12, 1986). Five days of hearings were held in June of 1987.

A good history of the UBIT can be found in James McGovern, The Use of Taxable Subsidiary Corporations by Public Charities -- A Tax Policy Issue for 1988, Tax Notes, March 7, 1988.

income derived from travel and tour activities should be treated as income derived from an unrelated trade or business, subject to the exemption below. ... Under the exemption, the UBIT should not apply to income derived by an education institution from travel and tour activities conduced for the benefit of its students or faculty if the travel or other is part of the degree program curriculum of the institution.

At about the same time, in 1988, the Small Business Committee also held hearings, this time on the broader impact of the advantages nonprofits, including nonprofit travel and tour promoters, receive.

That this matter was considered a priority of the Ways and Means Committee is clear. For example, in a letter from Chairman Rostenkowski to Congressman Pickle, Chairman Rostenkowski stated his top priority as follows:

Unrelated Business Income Tax: At the outset, I want to personally commend you and the Subcommittee Members for the extensive and thorough work the Subcommittee has conducted, over the past two years, on the unrelated business income tax. ... As you know, the unrelated business income tax has been in place since 1950 without effective Congressional oversight. ... As Chairman, I look forward to receiving a conceptual package of recommendations from the Subcommittee. Accordingly, you and the other Subcommittee Members are to be commended for the package of draft recommendations the Subcommittee has developed to date. I consider consolidation of the Subcommittee's work on the unrelated business income tax to be a priority matter....

All told, more witnesses and more Congressional attention was devoted to the issue of unfair competition in the last eight years than in the hearings that gave rise to the 1950 unrelated business income tax.

Of course, the small business complaints have found expression in other than Congressional hearings; including, most recently, the White House Conference on Small Business. One of the top 15 issues of all delegates to the White House Conference on Small Business conducted in 1995 and 1986 (the last two conferences) was unfair competition resulting from Governmental and nonprofit activities. According to the delegates' recent recommendation:

Support fair competition: *Congress should enact legislation that would prohibit government agencies, tax-and antitrust-exempt organizations from engaging in commercial activities in direct competition with small business.*[9]

[9] Report on the 60 Final Recommendations of the White House Conference on Small Business.

The issue of the proper treatment of nonprofit commercial activities is again at the forefront of policy debate. Extensive hearings before the Ways and Means and other Committees, written comments on discussion options released by the Committee,[10] and media coverage[11] have all elucidated the diverse and seemingly irreconcilable perspectives of the for-profit and tax-exempt communities. It should be borne in mind, that it is on the heels of this debate that the wealthiest non-profits, who cater to the wealthiest patrons, seek to relax the guidelines to dredge a safe-harbor for travel and tour promotion.

B. The Nonprofit Perspective

So what different perspectives control this debate? From the economic perspective, nonprofits do not believe they should be prevented from raising funds from commercial travel and tour operation. Operating a commercial enterprise in competition with for-profits virtually guarantees a means of fundraising. This is considered especially important in a period of *purported* down-sizing in Federal and corporate funding and increasing competition for donative sources of revenue.[12]

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[10] Ways and Means Committee Print 100-30, 100th Congress, 2nd Sess., (April 21, 1988). For example, many for-profits in the travel and tourism industry responded in written comments to the Subcommittee on Oversight's discussion options (*infra*) stated their concerns. For example, the American Bus Association stated that:

> *ABA members have faced increased competition from and have lost business to tax-exempt schools, colleges, universities, churches and other groups that provide bus tours and charter ... many ... are now providing tour and charter services to the general public or to tour groups ... the traditional market of tax-paying, commercial charger bus companies ... ABA supports [the Subcommittee's recommendation] for services that are part of a degree program, and those services are provided in furtherance of the tax-exempt organization's religious or educational functions ... ABA maintains that the exception for services provided as a part of a degree program should be carefully delineated.*

The American Society of Travel Agents, in an April 15, 1988 letter indicated as follows:

> *...UBIT should be imposed on those specified activities whose nature and scope is inherently commercial rather than charitable ... ASTA does not agree that a de minimus sales exception should be applied for non-students and faculty who purchase travel and tour services. ASTA supports exemption for a degree program curriculum ...*

[11] See, e.g. U.S. News and World Report, "Tax Exempt! Many nonprofits look and act like normal companies -- running businesses, making money. So Why Aren't they paying Uncle Sam?", pp. 36-51, October 2, 1995.

[12] Whether or not there has truly been a "down-sizing" of federal funding depends on how it is measured. Federal funding may not have kept pace with the explosive growth of non-profits but it certainly has not decreased.

Universities derive a significant percentage of their income from product and services sales. Four year private nonprofit institutions derived as a group 18.8 percent of their revenues from donations, as opposed to 51.9 percent from tuition, fees and other charges, and another 13.8 percent from government grants and contracts, between the years of 1986 and 1988.

From a philosophical perspective, universities and colleges in particular justify commercial activities for travel and tours by broadly construing the educational component of the 501(c)(3) exemption. The response of the University of Texas to the 1988 Ways and Means discussion options (as it describes its view of the 'educational experience') is instructive:

> *A significant part of a college education is based upon a student's extracurricular activities and his or her exploration of people and places which may not be at all related to the award of a degree. A university-related travel service should be able to provide travel assistance ... where the travel is related to any educational function of the university.*[13]

However, the current Treasury regulations consider education to include, with alarming generality, "instruction of the public on subjects useful to the individual and to the community."[14] Therefore, many universities maintain that travel and tour activities, simply because they are conducted by the tax-exempt, must be educational in nature. This point of view is integrated into the fabric of the proposed C&L guidance, which would give great deference to the university's conclusions as to the educational nature.

Still other nonprofits question whether the underlying complaints of small business. Some nonprofits question whether their activity competes with the for-profit sector at all,[15] or, if it so competes, whether the competition is "unfair." These nonprofits claim the business community is simply afraid of competition.[16]

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[13] See response to the discussion options of the University of Texas system, page 894.

[14] Regs. §1.501(c)(3)-1(d)(3).

[15] According to the comments of the American Association of Museums, in their response to the discussion options:

> *... we know of only one passing reference to a museum that competed unfairly with a taxable business.*

For example, the Currier Gallery of Art, in their response to the discussion options stated:

> *We also offer a series of art related travel tours for our members. While we do not offer college credit for these trips, they are carefully designed to be educational. These tours provide our members an opportunity to study the arts in depth, under the guidance of qualified staff, they are in no way "sight seeing" tours and we do not compete with the travel/tour industry.*

[16] According to the Center for Nonprofit Corporations, in their response to the discussion options:

> *There is little dispute ... that competition ... has been increasing. But is this competition unfair. Statistics have not proven that non-profits enjoy an unfair competitive advantage over small businesses; furthermore small businesses themselves enjoy a number of tax benefits and preferential treatments ... In a society ... which has regarded competition as ... healthy, measures to diminish competition should not be enacted..*

Other organizations fear "accounting" problems stemming from enforcement of UBIT.[17] Other claim that there would be minimum revenue gain to the Treasury, at great costs to the organization.[18] Still, others believe the taxation of some activities will curtail or eliminate these activities.[19] Some equate taxation with a penalty.

And some seemingly apply a "destination" test rationale to balance the value of the revenues generated from non-taxed activity to the value of the revenues generated from eliminating the revenue foregone. For example, some tax-exempts state that exemption should extend to any activity where the organization serves the public interest. Since taxes remove resources from private hands to support broad public policy purposes, the argument goes, income earned by such an organization is appropriately exempted from tax.[20] The nonprofits view the enforcement activity of the Service as troublesome interference with their efforts to perform these public services. On behalf of these nonprofits, C&L complains the current enforcement is "not uniform", applies "inconsistent", "unclear", "unrealistic", "unpredictable" and "undesirable" standards that

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[17] According to the Columbus Museum, in their response to the discussion options, p. 315:

> *The proposed plan to change the UBIT seems ... an attempt to penalize those museums that have sought other means to generate revenue.*

[18] According to the Association of Art Museum Directors, in their response to the discussion options:

> *We are also concerned that the administrative accounting burdens which would be placed on the institutions appear to be tremendous, and this particularly should be considered in view of the modest impact which we believe all these options would have in raising tax revenues.*

According to the Association of Art Museum Directors, in their response to the discussion options:

> *Lastly, some ... have concerns with the application of the UBIT to ... travel and tour services ... We are deeply concerned about any erosion of income which these changes may cause.*

[19] For example, the Laguna Gloria Art Museum, in their response to the discussion options stated:

> *Travel services - While this is not significant income to us. Austinites must travel to places like ... Los Angeles to view important exhibitions ... [W]e are concerned that our tour prices not be prohibitive due to taxation of net income.*

The American Arts Alliance, in a somewhat inconsistent statement, said:

> *Special travel programs are ... used to ... develop new supporters ... and to provide an 'extra touch' to regular members services. To be taxed on the minimal amount of income such programs raise would force many institutions to drop travel services entirely.*

Their statement was echoed by that of the Brandywine Conservatory:

> *To tax the small revenues derived from travel services would almost certainly cause us to eliminate them.*

[20] See response to the discussion of Thomas J. Borby, Esq., p. 250

"do not properly consider the educational nature of these travel tours in light of all the facts and circumstances".

C. The Small Business Perspective

Small businesses are placed in an awkward position. Small businesses recognize the essential work of many nonprofits; indeed, while not often publicized, small firms are the largest contributors to non-profits on an employee-by-employee basis.[21] However, small businesses vigorously oppose nonprofit unfair competition. They oppose both nonprofit entry into the markets traditionally served by for-profits, as well as nonprofit domination of markets where for-profits would like to provide services and for which no exemption is appropriate.

At the same time, for-profits recognize that the 'substantially related' test was enacted with one purpose in mind: to stop nonprofits from unfairly competing against them. However, they recognize that it has failed at this task. Businesses are acutely aware that the 1950 law meant to protect them is anachronistic, never intended to restrain the current scope and size of nonprofit commercial enterprises, and demonstrably unable to protect small firms from the vast commercial enterprises of nonprofits.[22] They are also concerned that the laws currently in existence are not adequately enforced. Businesses complain that the manifold abuses resulting from unfair competition cut across industries, and are neither "episodic, exaggerated or extraordinary."[23]

Furthermore, for-profits point out that the inability of the "substantially related" test to perform its protective function is evidenced by data which show that the size and scope of nonprofit commercial activity has increase disproportionately to their reported UBIT. In 1985, for example, the total tax revenue raised from nonprofits was $40 million, at a time when their gross receipts were $250 billion. In addition, in that year, a random audit of Forms 990-T revealed that one-third of had deficiencies in UBIT reporting of between 30 and 50 percent.[24] These data are supported by the coordinated examination program results.[25] The data, made manifest by the anecdotal cases, translates into a strong perception of unfairness.

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[21] See, SBA, Office of Economic Research study: Small Business Contributions to Public Service Organizations. Per, Ed Starr, Ph.D.

[22] Indeed, businesses point to the tax-code as the virtual font of other exemptions in securities laws, labor laws, postal subsidies, local and state property exemptions *et cetera.*

[23] See response to the discussion options of Joseph O'Neil, Chairman, Business Coalition for Fair Competition, p. 258

[24] See, "Tax Policy: Competition Between Taxable Business and Tax-Exempt Organizations," Briefing Report to the Joint Committee on Taxation, U.S. Congress, by the General Accounting Office, February 1987, GAO/GRAD-87-40-BR

[25] See Daily Executive Reporter, Taxation, Budget and Accounting, recently attributing the following statements to Marcus Owens, Director of the Service's exempt organization division: "IRS audited 12000 returns in the tax-exempt sector in fiscal 1993, yielding a change rate of 73 percent. Audits of 2,232 Forms 990-T yield a 79 percent change rate."

Added on top of this is small businesses circumspection of the extremely questionable rationale for any tax exemption for travel and tour promotion. Small businesses maintain that, as a starting point, nonprofits should not be provided an exemption for activities that the business community can do without the benefit of exemption. This viewpoint, is pivotal to the economic and tax policy justification of the exemption itself and echoes the concerns of the Department of Treasury:

> *Limits on the scope of such tax exemption are appropriate and necessary. This Nation has prospered through its reliance on private, market-based economy to supply necessary goods and services. The role of the government generally has been restricted to those socially important activities not adequately supported by the private sector. The role of the quasi-governmental, not-for-profit sector should similarly be restricted to that of supplementing, and not supplanting, the activities of for-profit businesses. Thus, tax exemption for public charities should be restricted to those areas where the quality or quantity of goods and services that would be produced strictly through market forces is inadequate.*[26]

It is also, as noted, consistent with the preliminary findings of the Ways and Means Committee during their policy deliberations.

For many small firms, the only discernible distinction between their activities and that of the nonprofit is that one pays taxes and the other does not. Travel and tour promotions are one of those inherently commercial activities for which no exemption should be extended as a matter of policy. More to the point, however, small businesses recognize that most nonprofits engaged in travel and tour services are not serving the traditional markets for which exemption would be required. Indeed, rather than providing the services to those that could not otherwise afford it, businesses point out, the exemption enables nonprofit travel and tour promoters to tap and maintain access to the high-end, most lucrative part of the market -- the segment with the greatest disposable income, the greatest number of professionals and the highest component of educated customers. When this competition occurs, there is a distinct and quantifiable competitive advantage nonprofits enjoy from total relief from the income tax.[27]

For-profit travel and tour providers and operators point out that application of the "educational" definition sought by the tax-exempts would qualify virtually anything, especially any tour, as educational without limitation. Businesses believe that many tour and travel activities are clearly not related enough to the exempt purposes; and are frustrated that there is little, by way of practical enforceable or objective tests for distinguishing what is pedagogical from what is not.[28]

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[26] Hearings before the Subcommittee on Oversight, Ways and Means Committee, June 22, 1987. Serial 100-26.

[27] *Id*

[28] In their response to the discussion options, the National Tour Association stated:

Perhaps most importantly, businesses agree with the Treasury, the Service[29] and the General Accounting Office,[30] that the current substantially related standard is vague and difficult for agents to enforce. According to testimony by then Assistant Secretary Don Chapoton:

> *Our primary concern with the 'substantially related' test is whether in practice it has been useful in distinguishing activities entitled to exemption, from those that are not. The general concepts enunciated in the regulations inherently require facts and circumstances determinations that are not likely to achieve consistency among different exempt organizations. The practical result appears to be an ad hoc test that, in may cases offers inadequate guidance to the courts, exempt organizations and revenue agents. Moreover, to the extent the relatedness standard has provided guidance, there are indications it has been applied in an overly generous manner. Some courts appear to have found the requirement ... satisfied when the activity contributed simply in some way to that purpose.*[31]

Businesses are painfully aware of the difficulties of uniformity in enforcement and accounting. However, businesses believe guidance to make matters uniform should not be achieved at the cost of deviating from current law. Small businesses do not understand why, when the UBIT has demonstrably and resoundingly failed to halt the tide of unfair competition, and when the enforcement has had admittedly mixed effect, that the nonprofits could then argue for an enhanced safe-harbor. In the context of travel

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> *We concur with the inclusion of [tour and travel services] among the services which are inherently commercial. We offer no objections to the stated exception regarding ... such services provided by colleges, universities to students/faculties as a part of a degree program curriculum ... this places the services in a direct relation to the purpose of the college or university and through providing the Service to the student /faculty eliminates the commercial nature of the services*

[29] According to then Commissioner, Lawrence Gibbs:

> *...application of the tax requires a very subjective decision that is based on the facts and circumstances of each case. Again, I will not go into them in detail other than to mention them and to express my opinion that they do cause administrative difficulties for the Internal Revenue Service. Specifically, whether an activity is or is not substantially related to an exempt purpose. Again, this has been a difficult area for us in making decisions that require an examination of the relationship between the income-producing activity itself and the accomplishment of the exempt purpose....*

[30] According to Jeannie Stathis, then Associate Director, General Government Division, U.S. General Accounting Office:

> *Administering this tax, can be difficult because of the individual circumstances that must be considered to determine whether an activity is substantially related to an exempt purpose. Id at p. 133.*

[31] At p. 28.

and tour activities, small businesses support more succinct guidance that will finally and definitively separate the classroom from the vacation.

II. The C&L Approach Summarized

The C&L proposal is premised on the goal of providing uniform standards for determining whether or not tour and travel services provided by 501(c)(3) organizations are "substantially related" and therefore exempt from federal income tax. The C&L proposal states that the Service is currently providing "inconsistent" and "unrealistic standards" for the tax exempt community to follow. Due to these unrealistic standards, they argue, the Service must adopt newer, clearer standards which will place the 501(c)(3) into a safe harbor of activity. Within this safe harbor, C&L maintains, the services performed by the non-profits will clearly and significantly contribute to the educational mission of their community.

To summarize the C&L approach, there ought to be four general categories of inquiry in the evaluation for the "substantially related" test. In evaluating the substantiality of the relationship we must ask: (1) is the tour is sufficiently linked to the organization's goals or mission?, (2) who organized the tour?, (3) is the tour marketed as a commercial or exempt tour?, and (4) what is the linkage between the operation of the tour and the overall educational mission?

For purposes of determining the linkage of the activity to the organization's goals or mission, C&L merely enumerates factors, indicating they are relevant:

- the organization has a mission statement articulating the relationship of tours to its exempt purpose.
- the tour is predominately educational, not recreational.
- the tours relate to an area of program focus.[32]
- the tour is designed to attract those interested in the organization's mission, which may include students, members and alumni.
- the tours offer information, contact with local experts, access to places or other opportunities linked to the exempt purpose.[33]
- the organization ensures that tours have an "expert or *other qualified person* to address the tour concerning a topic relevant to the tour's focus." [emphasis added]
- the number of tours are commensurate with the scope of the organization's other exempt activities.[34]

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[32] The organization clearly articulates the programs it seeks to enhance and the relevance to the programs of each tour.

[33] C&L provides a very broad example. According to C&L:

> *For example, tours that include as part of the trip information or sites not generally visited by commercial tour operators that allow the study of wildlife may further the educational mission of a conservation, environmental or other educational organization that conducts programs on natural history. [emphasis provided]*

[34] As discussed later, this criterion seems to say that a bigger wrong can make a right.

As far as the second category of consideration -- who organized the tour? -- is concerned. C&L proposes that it important whether or not the organization's staff was involved in planning the tour, whether the organization is involved in selecting itineraries and whether the tour is evaluated at an appropriate level to assure that it promotes exempt purposes.[35]

Marketing, C&L suggests, is another determinant that distinguishes "exempt organizations from commercial tour operators". According to C&L, there are two relevant lines of inquiry in separating substantially related exempt organization marketing from unrelated marketing. The first line of inquiry asks to whom the tours are marketed, *i.e.* whether the tours are marketed to members who have expressed interest in mission of the organization or open to the public. The second line of inquiry asks in what manner such marketing takes place. According to C&L, promotional materials that emphasize the educational content of tours (as opposed to recreational content) and explain the relationship to the mission of the organization, contain qualifications of experts on tour, and expressly distinguish the tours from commercial tours, indicate that the trips are substantially related.

Finally, the last line of inquiry is what C&L describes as the "operation and education component." This component consists of the following:

- the content of the tour is "relevant to focus of organization."
- participants are furnished with "pre-tour reading lists" and other materials.
- significant portions of time are arranged to "allow participation in the educational programs."
- tours include an educational methodology; for example, classroom lectures, field trips, and on-site meetings.
- *review* of the tours on a *regular* basis to ensure that the program is meeting the educational goals of the sponsoring organization and that participation is at an *appropriate* level.
- tour follow-up materials are provided, such as trip logs, bird lists, time lines *et cetera*.
- Social and recreational activities are limited to provide atmosphere conducive to learning activities.

While the C&L preamble to the proposed revenue procedure indicates that these factors are conclusive, it fails to specify how many factors (if not all factors) need to be considered or the relative importance of the various factors.

[35] C&L adds that commercial tours may be subcontracted if they meet the educational standards of the organization.

III. Current Law Governing the Taxability of Nonprofit Travel and Tour Businesses

A. Legislative History of the Unrelated Business Income Tax (UBIT)

Until the Revenue Act of 1950 (hereinafter the "1950 Act")[36] imposed tax on UBIT (and made certain other changes)[37], commercial income was typically tax-exempt if the income had a charitable destination.[38] However, public charities which engaged in the active conduct of trades or businesses were seen as unfairly competing against taxable businesses.[39] Taxable businesses argued that they would be forced to charge higher prices than public charities to achieve the same profit margin. Further, unlike public charities engaged in a trade or business, taxable businesses could expand operations only with the profits remaining after the payment of income tax.

These unfair competition concerns prompted Congress, after considerable deliberation, to enact the UBIT as part of the Revenue Act of 1950,[40] instead of limiting the tax-exempt status of public charities which conducted trades or businesses. Through the UBIT, Congress instead chose to impose the regular corporate income tax:

> *with respect to so much of their income as arises from active business enterprises which are unrelated to the exempt purposes of the organizations.*[41]

There is no doubt that the Congress intended, as its underlying objective, the prevention of unfair competition by tax-exempt entities against taxable entities. According to the Senate and House reports:

> *The problem at which the tax on unrelated income is directed is primarily that of unfair competition. The tax-free status of Section 101 organizations enables them to use their profits tax-free to expand operations, while their competitors can expand only with the profits remaining after taxes.*[42]

The Supreme Court has so held that this was the legislative intent of the unrelated business income tax in the 1986 Supreme Court decision in *U.S. v. American Bar*

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[36] P.L. 814 (Ch. 994), 81st Confess, 2nd Session, 64 Stat. 479, 906.

[37] Most notably, the Act also precluded exemption for for-profit businesses whose profits were paid over to an exempt organization (so-called "feeder organizations"). See present law 26 U.S.C. 502.

[38] See, e.g. *Trinidad V. Sagrada Orden de Predicadores*, 263 U.S. 578, 581, 44 S. Ct. 37 (1924); *C.F. Mueller Co. v. Commissioner*, 190 F.2d 120 (3d Cir. 1951).

[39] H.R. Rep. No. 2319, 81st Cong., 2d Sess. 36 (1950).

[40] P.L.. 81-814, 64 Stat. 906.

[41] H.R. Rep. No. 2319, at p.36.

[42] Section 101 was the precursor to present law section 501. S. Rep. No. 2375, 81st Congress, 2d Session (1950). See also, H. Rep. No. 2319, 81st Congress, 2d Session (1950).

Endowment, 477 U.S. 105.[43] There, the Court held that: "The undisputed purpose of the unrelated business income tax was to prevent tax-exempt organizations from competing with businesses whose earnings were taxed." Similarly, in *U.S. v. American College of Physicians*, 475 U.S. 834:[44]

> *tax-exempt organizations were able to carry on full-fledged commercial enterprises in competition with corporations whose profits were fully taxable. Congress perceived the need to restrain the unfair competition fostered by the tax laws.*

In 1969, Congress reexamined the effectiveness of the UBIT, and found it wanting. Many of the unfair competition concerns that prompted the UBIT persisted unabated. In some instances, the UBIT was encouraging tax avoidance, in other instances, organizations not subject to the UBIT were still unfairly competing against for-profits. In response, the Tax Reform Act of 1969[45] substantially broadened scope of the unrelated business income tax, *inter alia*, extending it to social welfare organizations, churches and farmer's cooperatives.

B. Relevant Statutes

The Code describes in relatively broad terms the type of tax-exempt business income that is subject to tax. Section 511(a), for example, imposes a tax on the "unrelated business taxable income" (as defined in section 512) of every organization described in "sections 401(a) and 501(c)" as well as on "state colleges and universities."

According to section 512, the term 'unrelated business taxable income' means "... the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business."

Section 513 then defines the term 'unrelated trade or business' to mean

> *any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption under section 501 ... [emphasis provided].*

The operative phrase, of course, is that the activity must be 'substantially related' to the exempt function of the organization to escape taxation.

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[43] 91 L.Ed.2d 89, 106 S.Ct. 2426,2432.
[44] 838, 89 L.Ed.2d 841, 846, 106 S.Ct. 1591, 1594.
[45] P.L. 91-172, §121 (1969).

C. Relevant Regulations

The regulations dimly illuminate the circumstances under which application of the UBIT is required. Regs. §1.513-l(d), for instance, provides that determining whether or not income is substantially related:

> *necessitates an examination of the relationship between the business activities which generate the particular income in question -- the activities, that is, of producing or distributing the goods or performing the services involved -- and the accomplishment of the organization's exempt purposes*
>
> *Trade or business is 'related' to exempt purposes, in the relevant sense, only when the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income) and it is 'substantially related' for purposes of section 513, only if the causal relationship is a substantial one*

Furthermore, under Regs. §1.513-l(d), where the production or distribution of the goods or the performance of the service does not "contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business." Moreover, where income is realized by an exempt organization from activities, which are in part related to the performance of its exempt functions, but which are conducted on a larger scale than is reasonable necessary for performance of such functions, the gross income attributable to that portion of the activities in excess of the needs of the exempt functioned constitutes gross income from the conduct of unrelated trade or business.

Through the regulations, we know that the UBIT is to be applied only where there is not a causal relationship or the causal relationship is not substantial, where the income does not contribute importantly to that purpose, or where commercial activity is conducted on a larger scale than is reasonable necessary.

D. IRS Pronouncements

The issue of whether the tour is substantially related to the organization's exempt purpose or primarily a vacation that is educational only in a broad sense is not explicitly addressed by statute. Indeed, the quantification of the "fun" factor versus the "educational" factor has proven to be difficult. Nevertheless, the Service has, in several Revenue Rulings, Technical Advice Memoranda, and Private Letter Rulings addressed particular factual scenarios.

1. Tour Activity Unrelated to the Exempt Purpose

Several key decisions by the Service elucidate the factors which, if present or absent, indicate taxability. For example, the Service has long taken the position that the task of merely arranging for travel is not educational, even if the tours are available only to students and faculty of a university. In Rev. Rul. 67-327,[46] for example, the Service held that a non-profit organization formed for the purpose of arranging group tours for students and faculty of a university to allow them to travel abroad (and which has no other activities) is not entitled to exemption from federal income tax under section 501(c)(3) of the Code. This ruling made clear that the arranging of tours is not, *per se* "educational" in the sense of improving or developing an individual's capabilities.

Likewise, in Rev. Rul. 78-43,[47] an association, working with various travel agencies, scheduled several tours annually to destinations around the world, mailed out promotional material, accepted reservations, and was paid a fee by the travel agencies on a *per* person basis, but did not engage in "education" within the meaning of Section 513. The Service found that by making available the travel tours in the manner described, the organization was merely furnishing a regularly carried on commercial service not substantially related to the educational purpose of the organization.[48]

In TAM 9540002, the IRS was presented with a nonprofit tour activity which was so commercial in nature that the Service prospectively invalidated the exemption. In doing so, however, the Service opined in *dicta* that, had not the commercial enterprise so tainted the organization, the activity would have certainly have been considered unrelated. Under the facts in TAM 9540002, a program was organized to supplement the efforts of the government through the United States Information Agency in broadening "understanding and friendship with people of other nations". The exempt entity was formed in 1957 in order to accomplish the objectives of the program through sports. Its stated purposes were to:

> *assist in promoting closer understanding and cooperation among the people of the United States in learning about other nations while encouraging other nations to learn about the United States' athletic capabilities, sports traditions, and history and enhance the cause of world peace by encouraging and assisting private American groups and organizations to promote international understanding through the development of new, and expansion of, present sports activities.*

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[46] 1967-2 C.B. 187.

[47] 1978-1 C.B. 164.

[48] Rev. Rul. 77-366, 1977-2 C.B. 192, held that a nonprofit organization that arranges and conducts winter-time ocean cruises during which activities to further religious and educational purposes are provided in addition to *extensive* social and recreational activities is not operated exclusively for charitable purposes and does not qualify for exemption under section 501(c)(3) of the Code. (Emphasis added). In contrast, Revenue Ruling 77-430, 1977-2 C.B. 194, held that an organization that conducts weekend religious retreats open to all Christian sects, at a rural lakeshore site at which the participants may enjoy the recreational facilities in their *limited* amount of free time without fee qualifies for exemption under section 501(c)(3) of the Code as operated exclusively for religious purposes. (Emphasis added.)

The largest of the programs during the years under examination were its golf and tennis tours. Through these programs, the exempt organization arranged foreign tours for teams of amateur American players. Individuals and couples paid significant amounts to participate in such tours. A typical golf tour cost $7,000 with participants visiting six cities in three weeks. In each city, participants were required to participate in at least one golf match, required practice rounds and official receptions.[49]

2. Tour Activities That are Substantially Related

The foregoing can be contrasted with a line of rulings in which the activity was found to be exempt because it was substantially related. In Revenue Ruling 69-400,[50] the Service held that a nonprofit organization that selects students and faculty members who are interested in a foreign history and culture and enrolls them at foreign universities qualifies for exemption under section 501(c)(3) of the Code. The ruling distinguished Revenue Ruling 67-327 on the basis that the tours conducted by the organization complemented classroom study of a particular country and so advanced education.

Revenue Ruling 70-534,[51] held that a nonprofit organization whose primary activity was conducting travel study tours that included courses on the culture of the United States, foreign countries, and nature studies taught by certified teachers is exempt. The ruling noted that the studies included lectures, preparation of reports, recitations, examinations, and the issuance of grades. Consequently, the organization instructed the individual in such a way as to contribute to the improvement and development of his capabilities.

In Technical Advice Memorandum 8034022, the Service was presented with the issue of whether or not the sponsorship of study travel tours by a museum were exempt from taxation. The Service held that "the absence of educational content in each of the tour programs is fatal to the causal relationship." The Service found such a relationship present in the TAM.[52]

In Technical Advice Memorandum 8115025[53], the Service arrived at what may be its most lenient decision on substantially related travel and tour programs. Under this TAM, a liberal arts college for men and women, organized under 501(c)(3) of the Code, sponsored travel and tours through a travel agency to many foreign countries as well as

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[49] The Service concluded the operation of the golf and tennis tours did not contribute importantly to the exempt purposes and would have generated unrelated business taxable income if the national office had determined that this activity was not already a bar to exemption.

[50] 1969-2 C.B. 114.

[51] 1970-2 C.B. 113.

[52] However, it is difficult to determine from this TAM the factual bases upon which the decision was reached, since the TAM removes much factual material from discussion. The Service, of course, is restricted in publishing TAMs from mentioning too specific factual bases that may alert others as to the identity of the taxpayer.

[53] January 2, 1981.

certain designations in the U.S. The participants in such tours consisted of students, faculty, alumni, staff and friends. As an added service, the tour presented members travel-related seminars, films, lectures and social events in connection with the trips and tours.

In support of its contention that its operation of travel tours was an educational activity and not subject to tax as unrelated business income, the college had qualified faculty members, who were specialized in the countries, customs and history of the regions, accompany the tours and offer lectures during the course of travel. Lectures on the areas visited were presented while traveling and seminars were also conducted before or following each trip. In certain instances, a certificate was given to each tour participant demonstrating attendance at the lectures, and tours are offered in connection with academic courses for which college credits were given. In the words of the Service:

> *Recent submissions by X indicate that its operation of travel tour arrangements are substantially related to its exempt purposes. Lectures are offered both before and during the tours. In a number of instances the tours are an integral part of the academic course of study. Faculty members who participate in the tours and who also act as guides have specialized expertise in the countries visited. By offering travel tours in conjunction with academic courses of study and by providing lecture series and qualified academicians as part of each tour, the activity is furthering its educational purposes.*

The Service found the operation of travel tours analogous to the situation described in Rev. Rul. 70-534, in which an organization conducting travel tours was found to be educational where it included courses of study as an integral part of its activities. However, this TAM represents the outer limits of the Service's exempt treatment.

Indeed the Service has more recently required a showing that the educational component is a *primary* purpose of the tour in question. For example, in Private Letter Ruling 8303013, in the case of an organization organized to increase knowledge of art, history, design, science and other topics, the Service noted that arranging tours would not in itself contribute importantly to the accomplishment of the organization's exempt purpose. The Service instead took the position that "[t]he absence of *primary* educational content in each of the tour programs is fatal to concluding that a causal relationship exists between the programs, and the purported exempt purpose of promoting education or religion." [emphasis added]

The requirement that the educational content of a tour be *primary* subjects the organization to a much more intense form of scrutiny and requires more detailed evidence in support of the position that the travel tour is substantially related to an organization's educational purpose.

In PLR 8303013, the Service was presented with the following issue:

Whether the sponsorship of study travel tours by B, exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code, which include classes on areas of travel before departure, professional museum staff study tour leaders, lectures by local experts and qualification of programs for university level credit constitutes unrelated trade or business within the meaning of section 513

Under the facts of the ruling, staff or members of other educational or cultural organizations proposed tours and evaluated the tours for the relationship of the tour with activities of the exempt organization. The tour involved lectures by qualified study leaders, and the tour was integrated with lectures or classes to provide an element of educational continuity.

After an itinerary was finalized, a professional tour operator, under contract, arranged for transport and accommodations. Tours were led by professional staff with expertise in the areas to be visited. Scholars from other organizations and lectures from the area to be visited often participated. Moreover, certain tours were arranged in conjunction with classes of a five to eight week duration offered. Some tours offered an optional two day lecture program by curators and specialists in advance of departure. In some instances, academic credits were awarded to participants who attended colleges and universities.

The Service found existing authority makes it clear that the arrangement of tours is not in itself an educational activity which furthers an exempt purpose.

The absence of primary educational content in each of the tour programs is fatal to concluding that a causal relationship exists between the programs and the purported exempt purpose of promoting education or religion. ... Without such a relationship, the sponsorship of each of the tour programs would fail to contribute importantly to an exempt purpose.

The B study tour programs combine a constant mix of professional tour leaders, daily lecturers, lectures by local scholars and experts, related classroom studies, trip visits available only because of B contacts, and possible university credits. The presence of these factors in B's study tours is sufficient to support the conclusion that a causal relationship exists between the study tours and B's exempt purpose of promoting education and diffusion of knowledge in the arts, science, history, and culture of our world. The existence of such relationship ensures that the tours contribute importantly to the exempt purpose of B. Accordingly, the tours are substantially related within the meaning of section 513(a) of the Code.

IV. The Coopers and Lybrand Approach Analyzed for Content and Administerability

A. The C&L Approach Would Deviate Widely from Current Guidance to Dredge a Broad and Deep Safe Harbor

The revenue proposal sets out its intended purpose thusly:

> *[to] provid[e] uniform standards which it hopes will provide more guidance for tax exempt organizations and a safe harbor that can be applied by Exempt Organization Examiners.*

The "Table of Leading Existing Guidance" in this section simplifies and summarizes the determinative factors in existing guidance. The Table is an attempt to compare and contrast the factors the Service has taken into consideration in determining the opposite outcomes of taxable and non-taxable activity. These factors are then compared with those advanced in the C&L proposal.[54]

When the factors in the *substantially related category* are compared with those absent in the *not substantially related category*, and again compared with the *C&L proposed factors*, two observations can be made. First, there exists a wide gulf between the facts presented in the published guidance where the Service ruled favorably for the nonprofits and the facts presented in unfavorable decisions. As a consequence, there is an undeniably wide gray area between published decisions finding taxability and non-taxability.

Second, the proposed C&L proposal would not standardize current authority. Rather it is inconsistent with existing guidance in both the formulation of standards and the application of those standards to determine the safe harbor. The C&L approach attempts to jettison the bulk of these requirements and substitute in their stead a panoply of inexact considerations and decidedly liberal tests that would be considered in determining whether the tour promotion activity fell within an undefined safe harbor. The C&L approach is an attempt to bring activities currently deemed taxable within the purview of a new poorly constructed safe harbor,[55] and would also carve a safe harbor out of the area now substantially lacking in authority.

The following table indicates which factors where present or absent when the Service found in the indicated Revenue Ruling or Technical Advice Memorandum that an activity was or was not substantially related. An 'X' indicates that the factor was present in the facts considered in the indicated guidance. An 'O' indicates that the factor was absent. The table also indicates whether we believe that factor may be present or absent in a commercially operated tour.

As the private letter rulings indicated *supra* and the preceding table indicate, a limited number of factors were present when the Service found the activity to be exempt from taxation. In all three rulings where the tour was substantially related, the tour was part of

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[54] The "Table of Leading Existing Guidance" set forth above summarize the primary factors that existing guidance has weighed in determining whether tour activity is exempt or taxable. However, comparison with the C&L approach is complicated by the fact the proposal does not ascribe any weight to the factors, as discussed *infra*.

[55] In contrast, the approach outlined in this submission is largely consonant with existing guidance and simply tries to clarify the analytical issues involved by creating an understandable regulatory framework by which the issues may be decided.

TABLE OF LEADING EXISTING GUIDANCE

X = factor present in indicated guidance
O = factor absent in indicated guidance

Factor Considered	Factors Present When Activity Found Substantially Related			Factors Present When Activity Found Not Substantially Related			Factors Present Comm. Tours
	Rev. Rul. 70-534	TAM 8115025	TAM 8303013	Rev. Rul 67-327	Rev. Rul 79-366	Rev. Rul. 78-43	Commercial Tours
Classroom instruction lasted weeks	X	O	X	O	O	O	O
Tour part of a study program with courses related to area being visited	X	X	X	O	O	O	Perhaps
Library on tour	X	O	O	O	O	O	Easily Arranged
Graded Examination	X	O	O	O	O	O	O
Credits offered or provided	X	X	X	O	O	O	O
Tours conducted by teachers	X	X	X	O	O	O	Perhaps
Tours directed towards students	X	X	X	O	O	O	X
Study materials provided	X	X	X	O	O	O	X
Lectures	X	X	X	O	O	O	X
Reports	X	O	X	O	O	O	X
Tours at suggestion of staff or members	O	X	X	O	O	O	X
Tours evaluated by staff	O	O	X	O	O	O	X

a study program with courses related to the area visited. credits were offered or provided. tours were conducted by professors or experts, tours were directed towards students, study materials were provided and lectures provided. In two of the three, classroom instruction lasted several weeks, and required reports were due. Where there was not an actual examination and a library on tour, the tours were evaluated by faculty and staff and suggested by faculty and staff.

The bottom line of these rulings is that all cases in which the tour activity was found substantially related resembled a traditional classroom setting, where the student demonstrated a desire to learn and the university demonstrated a *bona fide* desire to impart knowledge, even to the point of testing the knowledge acquired. Of course, in these fact patterns the educational integrity was also backed up by the institution offering credit or providing credits for the "courses", effectively putting its credibility where its income is.

When the activity was not found to be substantially related, each of these factors were absent. In addition, the tours were also offered to the public.

What does the combined guidance of the Service really mean as a dispositive test? First, it should be obvious that when a commonality of factors align in the ruling to deny exemption, such factors, when present, should always cause the activity to be taxable. However, the absence of one or more of these factors are not dispositive as to non-taxability. Likewise, the rulings finding the activity substantially related do not stand for the proposition that the factors outlined within them are exhaustive as to non-taxability.[56] The only factor we know for certain must be present, is that the educational content must be "primary" for a causal relationship to exist. As a corollary, therefore, the absence of these factors alone are not exhaustive as to taxability. They merely mean that if these classroom indicia are not present, the existing guidance, both precedential and non-precedential, suggest that the activity will not be tax-exempt.

On the other hand, while not exhaustive as to criteria, the rulings clearly suggest that the Service has a fairly well established set of criteria under which it has found activity to be substantially related. Consequently, if a true safe-harbor is to be developed, it must at least require the nonprofit to demonstrate compliance with the factors found to be present in the rulings finding the requisite nexus. Does the C&L approach require these factors to be present for the safe harbor to apply? The answer is clearly no.

The proposed C&L codification of current authority is simply not consistent with the existing guidance where the activity was found substantially related. In the C&L's safe harbor, there is no requirement that these factors be present. Indeed, the proposed

[56] Because the Service found the presence of these factors to constitute a substantial relationship in an educational context, does not mean that other factors would not likewise be considered to be substantial related.

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guidance liberalizes the actual educational content or opportunity required. For example, in test (5) of the 'Purposes and Content' section, C&L recommends:

> *[t]he tours offer information. For example, tours that include...information or sites not generally visited (sic) by commercial tour operators*[57] *...may further the educational mission [emphasis provided]*

Whether the tours "offer" or "include" information is an unjustifiably low threshold for determining that the tour imparts or ensures acquisition of knowledge. Could it be possible that the organization can "offer" information if it provides participants with a list of cites to publications currently available, a documentary film, or lecture that the participants will not read or view because they are preoccupied by sightseeing.

Test number (6) is also illustrative. While here C&L seems to build upon the requirements in current law that the program or tour offer lectures or guides that are experts, the C&L guidance expands on this requirement in the following way:

> *The exempt organization ensures that each tour has an expert or other qualified person to address the tour...the ...qualified person need not be affiliated with the organization, but it is sufficient that the organization, because of its reputation and contacts in a particular field can attract qualified experts with the necessary professional credentials...*

It is difficult to imagine a more ambiguous test. The failure of the tour to have available an expert should be dispositive as to the question of whether the tour is educational, but here the qualified person need not be an expert as long as the organization *can attract qualified experts*. The tests suggests that experts need not be available for the safe harbor to attach (a finding inconsistent with current guidance); rather, it is sufficient if the nonprofit can provide the possibility the organization can attract experts. If it can so provide this possibility, the tour is *ipso facto* educational. How does the ability to attract experts establish the educational content of the tour? If the tour attracted experts in the past, will this suffice to provide blanket non-taxability? How does C&L propose the Service enforce or verify this requirement?

Finally, we can look to test (8) which offers the following factor: "The number and scope of tours during the year is commensurate with the size and scope of the organizations other exempt activities." What does this mean? Certainly, rulings have found that the level and scope of commercial activities can be compared to the overall receipts of an organization as the Service questions the exempt status of an organization or the taxability of tax-exempt trade or business income (Reg. Section 1.513-1(d)(3)). This

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[57] Furthermore, the insinuation of the test that sites not generally visited by commercial tour operators is not conclusive as the nonprofit activity may have simply driven out or otherwise prevented the emergence of for-profits.

does not mean, however, that exempt travel and tour activities, if small in comparison to all commercial activities, is exempted for purposes of determining if the substantially related test is met. If this is the suggested interpretation, this test introduces a sort of relative *de minimus* formula into the audit guidelines, which is wholly unacceptable as a means of rewarding large violators over small violators.

There is at least one other case where the organization would simply have to offer the educational content. In Part D, the Operation and Education Components, the following factors are favorable. "The tour participants are furnished with pre-tour reading lists," and that "[s]significant portions of time...are arranged to *allow* participation in the educational programs [emphasis provided]." However, nowhere is there a participation requirement, or any similar requirement, that the organizations could rely upon to ensure that its mission was being fulfilled.

C&L also deems marketing considerations helpful. In the 'Marketing' section of the proposal, C&L suggests that "marketing the tours primary to an interested target audience that has an established interest in the mission of the organization is favorable." Here again the relevance of the test is dubious. Of course the marketing will be to those that have an established interest in the mission. Marketing should seek to efficiently target the most likely consumer. By establishing the target audience as "members, student, alumni and others" the test would encompass virtually anyone who has contact with the organization. Moreover, it is important to note the test does not exclude marketing to the general public.

Finally, the factors would suggest that the organization's review of educational content is evidence that the tour and travel has educational content. According to "Tour Development", "[t]he organization establishes appropriate criteria for review". However, allowing the organizations to establish their own criteria, and internally and conclusively certify that the content of the tours complies with the educational mission of the school, does nothing to ensure substantial relationship. Indeed, it delegates decisions to non-profit organizations and precludes the authority of the Service to objectively analyze their motivations. It is indeed clear that the organization is not requiring as rigorous an academic review standard as it would do for the allowance of credit hours, or continuing education credits.

Without providing standards or factors previously supported by a revenue ruling or other authority, the factors have little or no use to the Service which must base a revenue procedure on current law or policy. They certainly do not fulfill their purported mission of standardizing the existing guidance.

B. The C&L Approach Introduces New Standards and Then Fails to Clearly Enunciate These Standards

Perhaps as important as the substantiation of new factual criteria, the C&L "guidance" posits no fewer than five new standards for determining the substantiality of the linkage between the activity and the exempt function. For example, C&L's guidance would forbid the Service from finding activity taxable if it *furthers* the exempt function, *relates* to the exempt function, is of *relevance* to the exempt function, is *linked* to the exempt function, or even does as little as *promote* the exempt function. Moreover, once these new standards are advanced, the proposal does nothing to clarify their meaning.

For example, in Section B of the attached C&L proposal, three factors are enumerated that "indicate that the travel tour program *furthers* the exempt mission". "Furthers", of course, is a new standard, and a much more lenient test that is contained in the statute or regulations. Under current law, the activity must have a "causal relationship" to the exempt purpose and that relationship must be "substantial", that is, it must "contribute importantly" to the exempt purpose of the organization beyond merely raising money.[58] Mere "furtherance" of some exempt function is too attenuated a connection to be a meaningful standard.

Likewise, in section D, the C&L proposal finds the "opportunity to learn through interaction with outstanding professionals, who *can relate* the program to the objectives and mission of the institution, is itself educational ..." By the choice of this wording, it appears C&L is suggesting that the presence of this test is dispositive as to the substantially related standard. However, again whether or not a program "can relate" to an exempt purpose is not the same as saying that program must "substantially relate[]". In fact, it is difficult to divine a less demanding standard than an expression of the mere possibility of the existence of a relationship.

Also, in section D(1), C&L suggests another factor to be considered is whether "the content of the tours is organized around a theme or subject of study relevant to the focus of the organization." Again, mere *relevance* to the "focus" of the organization is not sufficient. The program must be *substantially related* to the educational purpose. In section (A), a proposed factor is that "the purpose of the tours offered is predominantly educational, not recreational." Whether the tours are "predominantly" educational is not the issue. Introduction of the term "predominantly" does nothing to clarify whether the tour is substantially related. Moreover, if the tours are in part related to the exempt purpose of the sponsoring organization and if the tours are "on a larger scale than is reasonably necessary" to further the exempt purpose of the organization, then they are taxable under the Code.[59] .

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[58] The "substantial" requirement may be viewed as analogous to the requirement in securities law that misrepresentations be "material".

[59] Regs. §1.513-1(d)(3).

In the 'Purpose and Content' section of the proposed guidance whether or not "the purpose of the tours offered is *predominately educational*, not recreational" is one of the prescribed tests. Apart from the obviously circuitous nature of this test, the term "predominantly" is again suggested as a substitution for the statutory term "substantially related", and is most likely meant to be a liberalization of that term. "Predominately" as regularly used in the Code, can mean the most significant motive or the primary motive, but need not be a "substantial" motivating factor if many factors are present.

To take another example, test (5) of the 'Purposes and Content' section suggests another factor is whether or not the activity is "linked":

> *[t]he tours offer information...linked to the exempt purpose of the organization. For example, tours that include...information or sites not generally visited (sic) by commercial tour operators...may further the educational mission.*

The insertion of the term "linked" would considerably liberalize the audit guidelines beyond what is "substantially related."[60] Also, whether it "furthers" the educational mission or not dilutes the test. The question under present law is not whether the activity "may further" the exempt purpose, but whether or not it "contributes importantly" to the exempt purpose.

Finally, the C&L guidance suggests that "Tour Development" is a favorable consideration if the tour is reviewed to determine if "it promotes the organization's exempt purposes." "Promotes" is the fourth test suggested by C&L and comes no closer to defining what is meant by substantially related.[61]

In the "Operation and Education Components" section, C&L suggests still another factor; if the "content of the tours is organized around a theme or subject of study relevant to the focus of the organization." Again, the "relevance" of a tour is not the correct standard of substantial relationship.[62]

C. The C&L Approach is Intrinsically Flawed Since it Provides No Means of Ascribing Any Priority to the Attributes of Exemption

Apart from the expansion of salient factors and the obfuscation the relevant standards, the proposed guidance fails to add clarity through clear and succinct methods of applying these standards. For example, the proposed guidance states:

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[60] The sword of Damocles was indeed linked by a follicle of hair, but no one would say that it was a "substantial" linkage.

[61] See discussion of regulations, *infra*

[62] On this standard, limitations on justifications are more a function of a lack of creativity. A trip to Disney World EPCOT Center may be relevant to engineers, or to sociologists.

The factors outlined in this document, if present, will conclusively establish that a travel tour program is substantially related to an organization's exempt purposes. Not all factors discussed must be present to draw this conclusion. However, the favorable factors will be weighted against the unfavorable factors to ensure that on balance the facts and circumstances are such that an educational objective related to the organization's mission is met.

This paragraph is internally inconsistent and adds significant confusion. An *ad hoc* test that weighs the favorable and unfavorable factors is not consistent with a dispositive, objective test that purports to "conclusively establish" that a program is a substantially related if "the factors outlined in this document" are present.

Furthermore, an *ad hoc* test such as this would not conclusively resolve anything until the facts are determined and the factors weighed. However, the proposed revenue ruling enumerates at least 23 factors to be considered. Any test that involves weighing 23 factors offers limited practical value to those trying to administer or comply with the law. A primary example of the difficulty of such a test is the 20 common law factors contained in Circular E for differentiating between independent contractors and employees. The problems on classification issues here should serve as an object lesson which suggests that such a list should be avoided.

D. The Proposed Guidance Offers a Safe Harbor, But Fails to Elucidate the Shoals or to Address the Varied Factual Scenarios Within the Uncharted Waters

While the proposed guidance purports to provide a safe harbor, it fails to show what behavior or activity will imperil the exemption of the commercial activities. By providing no information on the number of factors that will render activity taxable and by ascribing no weight to the various factors, the proposed revenue ruling offers no practical value to the Service or to the business community for whose protection the UBIT was enacted. Nor, for that matter, does it offer much by way of practical guidance for tax-exempt organizations conscientiously trying to comply with the law. If clarity and uniformity in enforcement policy is the primary purpose of this guidance, one would think it just as important for the tax-exempts to understand the behavior that is strictly forbidden if taxation is to be avoided.

Equally important, the proposed guidance fails to describe the many factual scenarios that exist in the marketplace today. The proposed guidance, if accepted, would enlarge the acceptable conduct of nonprofits but it would not clarify the vast gray areas where no guidance is provided. Within this area, as C&L suggests, programs would "still be examined and considered under the 'facts and circumstances' test presently used by the Service. However, it is this gray area in particular, which is most deserving of guidance.

In addition to deviating widely from current standards for determining what is 'substantially related', the C&L proposal is flawed in approach primarily because it is

wholly designed from the narrow perspective of what will satisfy the nonprofit community, without taking into consideration the Service's perspective (what will best administer the UBIT) or the business community's perspective (what will ensure that the UBIT serves its underlying function of protecting against unfair competition). From this vantage point, many of the shortcomings of the proposed guidance can be explained.

E. The Proposed Guidance Fails to Address Areas of Abuse, Such as the Allocation of Expenses

One of the other issues that contribute to unfair competition, apart from the taxability or non-taxability of income, is the allocation of expenses. If a taxable commercial activity of a nonprofit is sharing space with truly exempt functions of the nonprofit, is rent imputed? Can the nonprofit travel and tour activity reduce taxable income by the allocation of unreasonably high levels of expense, when these expenses are really borne by the nonprofit?

The proper allocation of expenses is an issue as integrally woven into the issue of unfair competition as is the allocation of income. According to the Treasury Department in its testimony before the Ways and Means Committee:

> *With respect to the computation of the tax on unrelated business income, we suggest that the rules for allocation of expenses be clarified to reflect the appropriate relationship between an organizations exempt functions and unrelated activities.*[63]

If true guidance is provided, expenses should be one of the items such guidance eventually covers.

F. The Proposed Guidance Would Focus Primarily on Universities and Colleges, When Other Nonprofits Also Engage in Commercial Travel and Tour Activities That Compete With For-Profits

It is important to note that, while colleges and universities have been actively engaged in promoting commercial travel and tour businesses in direct competition with for-profits, they are by no means the only category of organizations that engage in such activity. Various churches, museums, trusts and foundations, for example, have also stepped up their commercial travel and tour services. True guidance must also delineate what activities by non-educational 501(c)(3)s should be taxable.

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[63] See, testimony of Assistant Secretary Don Chapoton, at p. 24.

V. A Revenue Procedure May Not Be the Appropriate Vehicle With Which to Resolve These Issues

These determinations involve the resolution of major questions of substantive law, not merely process. Accordingly, the Service should appropriately seek to resolve these issues through the promulgation of a regulation; or in the alternative, if the non-profit community seeks to advance individual factual scenarios, in the context of various revenue rulings. A cursory analysis of the safe harbors reveals that the C&L proposal would necessarily involve determinations of substantive law and not procedure. In addition, the questions presented are of a magnitude that the input of all affected organizations should be sought.

For example, the "Purpose" section of the proposed revenue procedure provides an accurate overview of the broad substantive scope intended by the rule:

> *This revenue procedure provides guidelines that determine whether a travel tour program which is operated by an organization ... is substantially related to the accomplishment of the organization's exempt purpose and is therefore not taxable as an unrelated trade or business.*
>
> *The factors outlined in this document, if present, will conclusively establish that a travel tour program is substantially related ....*

The proposed "Revenue Procedure" asks, in short, for the Service to provide extensive guidelines to "conclusively" determine, in the form of a safe-harbor, the tax treatment of nonprofits' tour and travel activities.

In Revenue Procedure 89-14, the Service set forth the objectives of, and the standards for, the publication of such revenue procedures in the Bulletin, and provided some definitional distinctions between revenue procedures and revenue rulings. The purpose for publicizing both revenue rulings and revenue procedures in the Bulletin is to promote uniform application of the tax laws by Service employees and to assist taxpayers in attaining maximum voluntary compliance by informing Service personnel and the public of National Office interpretations of the internal revenue laws, related statutes, treaties, regulations, and statement of Service producers affecting the rights and duties of taxpayers.[64]

According to the Service, a "revenue procedure" is:

> *an official statement of a procedure published in the Bulletin that either affects the rights or duties of taxpayers of other members of the public sector under the Internal Revenue Code and related statutes, treaties, and regulations or, although not necessarily affecting the rights and duties of the public, should be a matter of public knowledge [emphasis added].*

A "revenue ruling", on the other hand, is:

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[64] Reg. Section 301.7805-1(c); Rev. Proc. 89-14.

an official interpretation by the Service of the internal revenue laws and related statutes published for the information and guidance of taxpayers, Service officials and others concerns.... Rulings and other communications involving substantive tax law ... are published in the form of revenue rulings. [emphasis added]

The fundamental distinction between these two forms of guidance is that the conclusions expressed in a revenue ruling will be directly responsive to, and limited by, the pivotal facts as stated in the revenue ruling itself. The conclusions drawn in a revenue procedure, as it is supposed to be confined to procedural issues, are not fact-intensive.

As the Service knows, the difficulty of applying a generalized ruling to define the vague contours of the substantially related test, as is suggested by the nonprofit community here, is legendary. The nonprofit community itself claims that the enforcement efforts are not uniform in application. However, guidance attempting to answer the difficult question as to whether the tour being offered resembles a classroom structure of a university or simply resembles a vacation must account for the wide varieties of fact patterns with which the Service and the taxpayers are confronted. The attempt to provide a general rule without application of individual facts more closely resembles a legislative role in the form of a revenue procedure than a regulatory role. If the Service is seeking to provide such a generalized rule, the better form for such a rule-making is defined in the Administrative Procedure Act, where the rule can be sufficiently noticed and the Service can take the time to elicit, hear and consider the many comments of affected entities and establish a number of working examples to replicate these fact patterns.[65]

VI. Adoption of the C&L Approach Would Fail to Take Into Consideration Serious Tax Expenditure Effects of the Safe Harbor

It has long been a stated position of the Service that, when developing regulations and rulings, revenue impacts of the resulting guidance must be considered. In numerous instances, therefore, when adding clarity to the law the Service does, indeed must, consider the effects of it ruling on tax expenditures.

If the suggestions made in the proposed revenue procedure were followed by the Congress, significant revenue diminishment would occur, at a time when the Service is increasingly realizing the importance of enforcement efforts against recalcitrant non-profits. If the Service were merely to introduce a safe-harbor, and nothing more, it would substantially reduce the estimated receipts from taxes.

The most obvious diminution of tax receipts would result, of course, from the conveyance of taxable income of for-profit firms into the nontaxable income of nonprofits, as nonprofit compete unfairly but effectively for the same marketplace. Nonprofits will

[65] Reg. Sec. 1.513 describes numerous fact patterns. In addition, organizations contemplating a substantial activity that is neither clearly related nor clearly unrelated might consider applying for a private letter ruling. A favorable ruling will protect the activity from adverse action by a Service auditor.

crowd for-profits out of markets traditionally served by the for-profit travel and tour promoters. The same revenue diminution will occur as would-be entrepreneurs, or existing for-profit travel and tour providers and promoters are discouraged from entering into new markets, the profits from which would be subject to taxation. Since there is at least empirical evidence to suggest that the travel and tour promoters of nonprofits target the wealthier market participants, there is also reason to assume that the loss of revenue would be proportionately higher for the same activity.

VII. The Guidance Should Provide Clear Standards for the Determination of Taxability

The proposed rule ought to accomplish its purported mission of clearly delineating factors that definitely establish taxability. The rule ought to ask the following questions: (1) What factors will conclusively determine the activity to be taxable? (2) What factors will conclusively determine the activity to not be taxable? (3) In the absence of a conclusive determination as to taxability, what factors must be weighed to determine whether the activity is taxable? In other words, the proposed rule should define the reefs and perils of taxability.

The rule should promote compliance by enunciation of clear, understandable standards for taxability and non-taxability. The tests, criteria and factors in the rule should be substantive, enforceable, and objective (preferably susceptible to quantification). The tests, criteria and factors should not elevate form over substance or merely make the nonprofit comply with a few bothersome procedural requirements to satisfy these perfunctory tests.

The rule should provide the factors that if present or absent conclusively determine that the activity is taxable. The rule should also provide the factors that if present or absent conclusively determine that the activity is exempt. The rule must also seek to shed some light on the larger gray area between the bounds provided by conclusively taxable or exempt activity. This may be done in a manner consistent with Congressional intent by providing taxpayers with a rebuttable presumption of taxability if these items are not present. This presumption may then be rebutted by establishing that the factors relevant under the rule are present to a sufficient degree and with sufficient weight.

Guidance should be consistent with the clear intent of the Congress when it enacted the underlying statute to prevent unfair competition. In furtherance of this purpose, when the facts are not such that a conclusive determination may be made under the rule and, therefore, the facts and circumstances must be weighed, the presumption should be that of taxability. The tax-exempt institution should be made to rebut the presumption that the income is taxable because to presume otherwise is to thwart the purpose of the statute. To reduce the scope of uncertainty and promote compliance, the rule should provide as many specific examples of the application of these relevant factors to specific facts as reasonably possible

The rule ought to anticipate the primary areas of unfair competition by seeking the factual scenarios from the business community. The business community would be more than pleased to provide the Service with examples that it believes are indicative of unfair competition that should fall within the ambit of the unrelated business income tax. In addition, however, the Service should rely upon data provided by the 1988 revisions to the Form 990 and by audits to help identify specific areas of non-profit activity with considerable overlap with the for-profit community. In the case of travel and tour promotion, such overlap can occur in markets defined by the customer base, by the locale served and by the mode of transportation.

Finally, the rule ought to provide a mechanism for the consistent communication to the Service of business concerns -- *i.e.* a mechanism where businesses can complain about potentially unfair competition. The Service Coordinated Examination Program for exempt organizations indicates that one factor in determining whether a case qualifies is whether "colleges and universities [have] multiple operations" and the unrelated business income of the organizations are appropriate for audit review.[66] Nowhere, however, does input from the business community rise to the level of an expressed consideration or does the existence of unfair business competition enter into the case managers' considerations either to identify the targets for review or to focus the resources once those targets are identified.

Two areas where this might have been logically inserted are IR Manual 7(10)(18)7.3 and IR Manual Exhibit 7(10)(18)0-3. In IR Manual 7(10)(18)7.3(2) for example, to determine those "areas which should take priority in the examination" the agents are advised to review "newspaper articles, books, magazine articles and other data pertinent to the examination cycle" Since the very *raison d'être* of the UBIT is unfair competition, the IR Manual should take this purpose into account. This will not only help to identify major cases, it will help to efficiently focus resources on specific and offending business activity. When the ratio of commercial to donative sources of income reaches a certain level, then inquiries should be made to determine if the entity qualifies for an EO Coordinated Examination.

The existence of unrelated business income does not always signify the existence of unfair competition. Nor does the mere fact of competition always mean that the activity is unrelated to an exempt purpose. The existence of unfair competition should, however, be a critical factor in determining whether business income is taxable.

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[66] The CEP indicates the elements the case manager must identify are "those areas which should take priority in the examination". See IR Manual 7(1)(18)7.3. The unrelated business income tax and unrelated business income are areas for which an ESAIN (340 and 510) are provided See IR Manual Exhibit 7(10)(18)0-1.

Appendix II
An Alternative Regulatory Approach to the Issue of Travel and Tour Promotion Activities

Proposed and Temporary Regulations

Unrelated Trade or Business (Travel and Tourism)

BACKGROUND

This document contains proposed amended regulations under sections 513 of the Internal Revenue Code. These regulations relate to the federal tax treatment of income arising from the travel and tourism income of tax-exempt entities. The regulations are proposed to be effective upon publication of final regulations in the Federal Register. The temporary regulations published ___,1995 were effective ____, 1995.

EXPLANATION OF PROVISIONS

Internal Revenue Code section 513, defines the term 'unrelated trade or business' to mean "any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption under section 501 ..." Regulation §1.513-1(d) states that determining whether income is substantially related "necessitates an examination of the relationship between the business activities which generate the particular income in question -- the activities, that is, of producing or distributing the goods or performing the services involved -- and the accomplishment of the organization's exempt purposes". "Trade or business is 'related' to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income) and it is 'substantially related' for purposes of section 513, only if the causal relationship is a substantial one." In addition, "where income is realized by an exempt organization from activities which are in part related to the performance of its exempt functions, but which are conducted on a larger scale than is reasonably necessary for performance of such functions, the gross income attributable to that portion of the activities in excess of the needs of the exempt functions constitutes gross income from the conduct of unrelated trade or business."

In the context of travel and tour promotions by tax-exempt organizations, additional guidance is required to clarify whether or not particular activity is taxable.

SUMMARY OF REGULATION

This regulation delineates factors that if present or absent conclusively demonstrate that travel and tourism income of a tax-exempt entity is substantially related for purposes of Regs. §1.513-1(d). The regulation also provides factors that, if present or absent, conclusively demonstrate that travel and tourism income of a tax-exempt entity is not substantially related for purposes of Regs. §1.513-1(d). The regulation provides factors that, in the absence of a conclusive determination, may be weighed in light of the facts and circumstances to determine whether or not travel and tourism income of a tax-exempt entity is substantially related for purposes of Regs.§1.513-1(d). Finally, the regulation provides factors that determine whether the travel and tourism program of a tax-exempt entity is on a larger scale than is reasonably necessary for the performance of a tax-exempt entity's exempt purpose.

SPECIAL ANALYSES

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. Although this document is a notice of proposed rule-making that solicits public comments, the notice and public comment procedure requirements of section 5 U.S.C. 553(b) do not apply because the regulations proposed herein are interpretive. Therefore, an initial Regulatory Flexibility Analysis is not required by the Regulatory Flexibility Act (5 U.S.C. chapter 6). Pursuant to section 7805(f)(1) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

COMMENT AND PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably a signed original and eight copies) to the Internal Revenue Service. All comments will be made available for public inspection and copying in their entirety. Written comments must be received by ___, 1995. A public hearing is scheduled for ___, 1995. See Notice of Public Hearing Published elsewhere in this issue of the Federal Register.

DRAFTING INFORMATION

The principle author of these proposed regulations is _____. However, other personnel from the Service and the Treasury Department participated in their development.

LIST OF SUBJECTS

26 C.F.R. §1.513-1(d)

PROPOSED AMENDMENT TO REGULATIONS

This document would add a new 26 C.F.R. §1.513-1(d)(4)(v).

REGULATION

§1.513-1(d)(4)(v)

(v)(A) *Travel and Tourism Trade or Business Generally.*

A travel and tourism trade or business is not substantially related to an exempt purpose for purposes of section 513(a) unless a causal relationship (under paragraph (d)(2)) exists between the travel and tourism and the achievement of the organization's exempt purpose. The presence or absence of certain enumerated factors may conclusively demonstrate a causal relationship or conclusively demonstrate the lack of a causal relationship. In the absence of a conclusive determination regarding the existence or lack of a causal relationship, then the rebuttable presumption is that the trade or business is not causally related. However, the taxpayer may rebut this presumption by demonstrating by a preponderance of the evidence that a causal relationship exists.

(B) *Factors Conclusively Demonstrating Causal Relationship.*

The following factors, if present, demonstrate conclusively that a causal relationship exists between the travel and tourism trade or business and the achievement of the organization's exempt purpose:

(I) the travel is a required component in a course (within the meaning of the accrediting agency) providing credit at an accredited educational organization within the meaning of section 170(b)(1)(A)(ii);
(II) the travel is conducted by faculty of an educational organization within the meaning of section 170(b)(1)(A)(ii) and the primary purpose of the trip is to further the faculty member's professional knowledge within his discipline or to participate in other professional activities;
(III) the travel is conducted by a curator or other professional staff at an exempt museum and the primary purpose of the trip is to further the curator's or other professional staff members' professional knowledge of matters pertaining to the subject matter of the museum's exhibits or to participate in other professional activities.

Example (1) S, a student at U, an accredited University, enrolls in a credit course that requires travel to site X away from U as one of the conditions of satisfactory completion of the course work. U requires S to pay for the trip. The trip is causally related to the exempt purpose of U.

Example (2) F, a faculty member of U that teaches Q, an accredited University, purchases a trip from U to site X to engage in detailed study of the Q of X. The trip is causally related to the exempt purpose of U.

Example (3) C, a professional staff member at M, an exempt museum that exhibits E, purchases a trip from M to travel to site X to engage in detailed study of E at site X.

{Other examples should be added. They may address other types of exempt organizations or other fact patterns}

(C) *Factors Conclusively Demonstrating Lack of Causal Relationship.*

The following factors, if present, demonstrate conclusively that a causal relationship does not exist between the travel and tourism trade or business and the achievement of the organization's exempt purpose:

(I) The primary purpose of the trip is recreational, or
(II) The primary purpose of the trip is administrative or commercial

Example (1) P purchases a trip to X from T, a tax-exempt organization. The trip involves visits to various sites of cultural and historic interest. These sites are the same sites typically visited by commercial tour operators and the guides and the information provided is similar to those typically provided by commercial tour operators. The activity is not causally related to the exempt purpose of U because the primary purpose of the trip is recreational.

Example (2) P purchases a trip to X from T, a tax-exempt organization. While on the trip P makes various visits on administrative or commercial business. But for these administrative or commercial visits, P would not have purchased the trip. The activity is not causally related to the exempt purpose of U because the primary purpose of the trip is administrative or commercial.

Example (3) P purchases a trip to X from T, a tax-exempt organization. While on the trip P makes various visits on administrative or commercial business. This visits were the primary purpose of the trip. The activity is not causally related to the exempt purpose of U because the primary purpose of the trip is administrative or commercial.

{Other examples should be added. They may address other types of exempt organizations or other fact patterns}

The following factors, if absent, demonstrate conclusively that a causal relationship does not exist between the travel and tourism trade or business and the achievement of the organization's exempt purpose (provided that the organization is exempt by virtue of being an educational organization):

(I) The primary purpose of the trip is educational

Example (1) A is an alumnus of U, an accredited university. A purchased a tour from U to X. The tour will visit many historical and cultural sites. These sites are the same sites typically visited by commercial tour operators and the guides and the information provided is similar to those typically provided by commercial tour operators. The tour is not heavily scheduled. Large blocks of free time are available. The activity is not causally related to the exempt purpose of U because the primary purpose of the trip is not educational but recreational.

Example (2) Same facts as example one, but free time is limited and the days are heavily scheduled. The activity is not causally related to the exempt purpose of U because the primary purpose of the trip is not educational but recreational. The fact that a tour contains many visits or events does not change its character.

Example (3) Same facts as example two, but A is a student or faculty member of U. The activity is not causally related to the exempt purpose of U because the primary purpose of the trip is not educational but recreational. The fact that a tour is enjoyed by a student or faculty member does not change its character.

Example (4) Same facts as three, but faculty members of U with specialized knowledge of the history and culture of X and other experts provide extensive lectures before and during the tour about the historical and cultural significance of what the tour participants will see, reading materials are provided to the participants and the content of the tour is substantially different than the tours offered by commercial tour operators and guides. The activity may or may not be causally related to the exempt purpose of U. The factors outlined in paragraph (D) must be weighed to determine whether a preponderance of the evidence demonstrates that the presumption of a lack of causal relationship should be rebutted.

{Other examples should be added. They may address other types of exempt organizations or other fact patterns}

(D) *Factors to Be Weighed in the Absence of Conclusive Demonstration of Causal Relationship.*

In absence of a conclusive demonstration of the existence or lack of a causal relationship under paragraphs (B) and (C), then the rebuttable presumption is that the trade or business is not causally related to the organization's exempt purpose. The presumption may not be rebutted unless it is factually shown that the sites and experts or tour guides in the tour are not substantially similar to those provided by commercial tour operators. Upon this showing, the following factors shall be weighed in light of the facts and circumstances to determine whether a preponderance of the evidence demonstrates that the presumption should be rebutted.

The following factors tend to rebut the presumption:

(1) a substantial portion of the tour consists of mandatory classroom lectures before and during the tour;
(2) a library is made available and used during the tour;
(3) a graded examination is administered or other objective demonstration of achievement is required of participants;
(4) the tour is conducted by faculty at an accredited University who have expertise in the subject matter or geographical area of the tour;
(5) substantive study materials are provided to the participants;
(6) activities performed by the tour participants contribute importantly to the base of knowledge in a field of knowledge;
(7) the marketing of the tour is limited to students;
(8) the content of the tour is approved by University faculty as being substantially educational in content.

The following factors tend to support the presumption:

(1) blocks of free-time or blocks of time devoted to recreation or entertainment are provided during the tour;
(2) an insubstantial portion of the tour consists of mandatory classroom lectures before and during the tour;
(3) no library is made available and used during the tour;
(4) no graded examination is administered or other objective demonstration of achievement is required of participants;
(5) the tour is conducted by persons other than faculty at an accredited University who have expertise in the subject matter;
(6) no substantive study materials are provided to the participants;
(7) activities performed by the tour participants do not contribute importantly to the base of knowledge in a field of knowledge;
(8) the marketing of the tour is directed at the general public;
(9) the content of the tour is not approved by University faculty as being substantially educational in content.

Example (1) P purchased a tour from U, an accredited university, to X. Tours to the site are not provided by commercial tour operators. X is an important archeological site where faculty of U are conducting excavations to uncover artifacts. The general public is not permitted to dig at X. P will participate in the excavations supervised by the faculty of U during all weekdays, participate in lectures before and during the tour and is required to read study materials and demonstrate his familiarity with those materials in order to participate. No particular provisions are made for recreation or entertainment in the tour but evenings and week-ends are free. The excavation is expected to contribute importantly to the understanding of the history of early X. The facts show that the sites and experts in the tour are not substantially similar to those provided by commercial tour

operators. Factors tending to rebut the presumption against a causal relationship outweigh the factors tending to support the presumption.

Example (2) P purchased a tour from M, an exempt organization, to X. The tour will visit many historical and cultural sites. The sites and tour guides in the tour are substantially similar to those provided by commercial tour operators. Therefore, the presumption against a causal relationship is not rebutted.

Example (3) P purchased from U a tour of the ancient cultural sites of X. Commercial tour operators do not offer tours of the ancient cultural sites of X (but do provide resort accommodations at the beaches of X). Commercial operators have no guides or experts in the ancient cultural sites of X. The tour is heavily scheduled. Substantive reading materials are provided to participants. Large blocks of free time are not available but large blocks of time are provided for recreational and entertainment activities. A library is made available and used during the tour to participants. No examination or other objective demonstration of achievement is required of participants. Classroom lectures are provided for the benefit of participants who wish to participate during the tour. The tour is not conducted by faculty of U. The facts show that the sites and experts in the tour are not substantially similar to those provided by commercial tour operators. The activity is not causally related to the exempt purpose of U because the factors tending to rebut the presumption against a causal relationship do not outweigh the factors tending to support the presumption. The fact that study materials and classroom lectures during the tour are provided to participants and that a library is made available to those wishing to use it does not outweigh the facts that U faculty are not conducting the tour; that mandatory classroom lectures were not provided prior to the tour, that significant blocks of time are made available for recreational and entertainment activities; no examination or other demonstration of achievement is required and the activities performed by the tour participants do not contribute importantly to the base of knowledge in a field of knowledge.

{Other examples should be added. They may address other types of exempt organizations or other fact patterns}

{In addition, detailed rules on expense allocation should be provided}

Executive Summary

Coopers and Lybrand (C&L), on behalf of approximately thirty museums, universities and other Internal Revenue Code (IRC) Section 501(c)(3) travel providers and tour operators, have submitted a proposed Revenue Procedure to the Internal Revenue Service (Service) outlining safe harbors for the non-taxability of the business income derived from such activities (See Appendix I). The nonprofit coalition's proposal is intended to alleviate audit burdens they are experiencing, and ostensibly to clarify the circumstances under which commercial travel and tour searches will be exempt from tax as "substantially related" to the exempt educational function.

The Business Coalition for Fair Competition (BCFC), an organization whose membership consists of the American Bus Association, the American Society of Travel Agents, the National Tour Association, the United Bus Owners Association and other for-profit travel and tour providers, [1] understands the Service is seeking to respond to these concerns by developing guidance on the proper treatment of nonprofit travel and tour promotion activities in the educational context. In addition, we understand the Service is considering the C&L proposed guidelines as a blueprint for a revenue procedure.

In exercising its discretion to develop this guidance, the BCFC believes it important, indeed critical, that the Service seriously consider technical and practical input from the affected business communities. These comments are provided as an preliminary means to provide input during your rulemaking process.

In summary, the BCFC believes that the C&L "guidance", if adopted, would be fraught with problems from a definitional, enforcement, policy and revenue perspective. First, the proposed guidance would fail to measure up to its own standards, by clouding, not clarifying, the standards for distinguishing substantially related from unrelated activity. Not only will the proposal inserts new and more liberal tests for what is and is not substantially related, but the proposal is fashioned in such a way that the responsibility for justifying the causal linkage between the activity and the exemption is delegated almost exclusively to the nonprofit on a subjective basis.

Second, when the proposal does provide objective criteria, it interjects new considerations that unjustifiably broaden established contours for related activities -- standards that are too liberal at the outset. Indeed, the C&L proposal would have the Service entertain standards for complete exemption from tax that are so liberal and so ill-defined, and so unenforceable, that they would not be remotely considered for purposes of determining the deductibility of items of for-profit expense -- including the charitable contributions or deductions for business travel.

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[1] Section 7.01(7) of the Revenue Procedure 89-14, encourages all interested parties to submit suggestions of generic issues that would be appropriately addressed in revenue procedures and revenue rulings.

Third, BCFC believes that the proposal's exclusive focus is misdirected towards defining a safe-harbor for nonprofits. The proposed guidance would significantly increase the level and breadth of unfair competition. Thus the proposal would exacerbate the very problem the unrelated business income tax was designed to prevent, without recommending administerable guidelines on what activities are taxable. This enlargement of the exemption would fail to add clarity, and it would also occur at a time when the Service is experiencing increased revenues from recalcitrant nonprofits, and when small business complaints about unfair competition has reached an audible pitch.

Fourth, if adopted, the proposal would fail to take into consideration serious tax expenditure effects of the safe harbor. These expenditure effects are appropriate considerations, as you know, in drafting rulemakings. Here, the revenue foregone effects of these changes are not insignificant, and are not justifiable on policy grounds.

Finally, a revenue procedure may not be the appropriate vehicle with which to resolve these questions of substantive law. Not only is the proposed guidance substantive in nature, but it is on a subject so controversial that notice and comment is essential.

BCFC believes the rule cannot produce clarity by liberalizing current law, but rather only by delineating factors that the Service will review, and the standards by which it will review those factors, in order to definitively establish taxability. Secondarily, the rule can add clarity by enunciating the criteria that, if present, would definitively cause the activity to be considered substantially related. The rule should then seek to promote compliance and administerability for numerous factual patterns which fall in the gray area by providing for a rebuttable presumption of taxability, and then by positing those factors that will rebut or substantiate the presumption. We also believe the rule should provide specific examples of these principals by setting forth exemplary fact patterns and determinations.

Additionally, BCFC maintains that in order to address the full gamut of the issues affecting nonprofit travel and tour services, the rulemaking should also encompass important issues concerning allocation of expenses and overhead. Moreover, the rulemaking should not merely focus on universities, but on the many other nonprofits including social clubs, museums and membership organizations that base exemption from taxation on other premises.

As a related procedural point, in order to efficiently focus enforcement resources and guidance, BCFC believes the rulemaking ought to address the most egregious areas of unfair competition by seeking suggestions of factual scenarios from the small business sector. For example, while the Service appears to be focusing exclusively on colleges and universities, for-profits are also experiencing unfair competition from such venerable groups as the Smithsonian Institution, the National Institute for Historic Preservation, churches and others. BCFC would be more than pleased to provide the Service with representative examples of unfair competition; and conversely, examples where unfair

competition does not exist. Indeed, perhaps the ruling can establish a format for logging such complaints so that they might be dealt with in a systematic manner.[2]

We offer for your consideration an alternative proposal. Our proposal, appended as Exhibit II, will advance the objective of clarification, preserve the fundamental underpinnings of the UBIT and current guidance, and prevent the activity from unfairly competing with for-profit suppliers.

This document is being submitted because of the importance of the issues presented and in the hope that the Service will incorporate these suggestions into its guidance for better enforcement of the UBIT.

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[2] In addition, however, the Service should rely upon data provided by the 1988 revisions to the Form 990 and by audits to help identify specific areas of nonprofit activity with considerable overlap with the private sector. Such overlap can occur in markets as defined not only by the customer base but also by the locale served and the mode of transportation. These and other recommendations are discussed in greater detail below.

I. The Perspectives of the Nonprofit and For-Profit Communities

A. The Context of the Dispute

The twin issues that confront the Service: the proper level of enforcement resources and the appropriate definition of the 'substantially related' test cannot be viewed in isolation, but must be placed in the context of an important ongoing debate. The taxability of travel and tour promotions, as with other commercial activity of nonprofits, is part of a public discussion which began more than one-half century ago with the enactment of the UBIT.[3] The purpose of the UBIT was to define the parameters of acceptable nonprofit activity deserving the highest incentive the tax code can provide -- full exemption.

Today, dissatisfaction over the lack of effectiveness of the UBIT in arresting unfair competition is simmering on the small business tax policy agenda. Rapid growth in the number of nonprofits and their vast asset holdings coupled with their increasing focus on commercial activity, have caused renewed concerns, particularly for smaller firms.[4] The crux of the business community's concern centers around the inadequacy the "substantially related" test, and they have repeatedly voiced these concerns.

In 1984, for example the Office of the Chief Counsel for Advocacy of the U.S. Small Business Administration, produced a key report on unfair competition by nonprofit organizations.[5] According to that report:

> *The issue of competition by nonprofit with small business is part of the much larger problem of government competition with the private sector. To the extent that the Federal government subsidizes nonprofit organization activity through the corporate income tax exemption in the Internal Revenue Code, nonprofit activity represents a form of indirect government competition*[6].

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[3] And perhaps even before that. In colonial America the Massachusetts Bay Province Laws of 1706-1707 provided exemption from local property and poll taxes for fellows and students of Harvard. Most other educational institutions were exempt. See Alfred Balk, the Free List 22-23 (1971); Columbo, John D., Why is Harvard Tax Exempt? (And Other Mysteries of Tax Exemption for Private Educational Institutions), 35 Arizona law Review 860.

[4] All told, the estimated 1.2 million organizations in the tax exempt sector have an estimated $1 trillion in assets. Overall figures are necessarily rough approximations since Churches do not file returns. According to IRS Statistics of Income Bulletin, Summer 1994, pp. 81-88, the revenues of tax-exempt organizations was 9.9 percent of the U.S. gross domestic product in 1990 up from 5.7 percent in 1975. Assets increased in *real* terms by 150 percent over than period and revenues increased by 227 percent.

[5] Uniform Competition by Nonprofit Organizations with Small Business: An Issue for the 1980s (June 1984, Third Edition). See also, U.S. SBA, Government Competition: A Threat to Small Business (1980). This was the report of the SBA Advocacy Task Force on Government Competition with Small Business.

[6] Id. at p. 1.

tour operators face competition by nonprofit organizations supported in whole or part by public funds. Because the operations of nonprofits are subsidized through Federal and state tax exemption and other benefits, they are frequently able to price tours lower than private competitors.[7]

Beginning in 1987, the Congress undertook comprehensive examination of non-profit business activity.[8] In announcing these hearings, Chairman Rostenkowski stated the purposes of the hearings thusly:

With limited exceptions, there has been no comprehensive review of the unrelated business income tax rules since 1969. Since that time there has been substantial growth in the tax-exempt sector of our economy.... In recent years, exempt organizations have become more aggressive in undertaking commercial or entrepreneurial activities. For-profit businesses have complained that tax-exempt organizations have become more aggressive in undertaking commercial or entrepreneurial activities. ... Indeed, the is issue of unfair competitive advantage has now reached national prominence as designated by the demonstration of this issue as priority items during the recent National White House Conference on Small Business.,

At these hearings, more than 300 witnesses testified, generating more than 2,300 pages of hearing record over five days.

On March 31, 1988, the Ways and Means Committee again considered the issue, this time in the context of specific discussion options, on which the Committee solicited public comment. In those discussion options, the Committee had recommended:

Apply[ing] UBIT to travel and tour services (with exception for services provided by colleges/universities to students/faculty as part of a degree program curriculum and de minim sales to non-students/faculty.

In the draft report describing recommendations on the UBIT of June 23, 1988, then Chairman Pickle of the Subcommittee on Oversight, Ways and Means Committee, determined that:

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[7] Id at p. 19.

[8] On September 12, 1986, the House Ways and Means Committee announced hearings to review the tax treatment of commercial activities of exempt organizations (Committee on Way and Means, U.S. House of Representative, Press Release Number 25 (September 12, 1986). Five days of hearings were held in June of 1987.

A good history of the UBIT can be found in James McGovern, The Use of Taxable Subsidiary Corporations by Public Charities -- A Tax Policy Issue for 1988, Tax Notes, March 7, 1988.

income derived from travel and tour activities should be treated as income derived from an unrelated trade or business, subject to the exemption below. ... Under the exemption, the UBIT should not apply to income derived by an education institution from travel and tour activities conduced for the benefit of its students or faculty if the travel or other is part of the degree program curriculum of the institution.

At about the same time, in 1988, the Small Business Committee also held hearings, this time on the broader impact of the advantages nonprofits, including nonprofit travel and tour promoters, receive.

That this matter was considered a priority of the Ways and Means Committee is clear. For example, in a letter from Chairman Rostenkowski to Congressman Pickle, Chairman Rostenkowski stated his top priority as follows:

Unrelated Business Income Tax: At the outset, I want to personally commend you and the Subcommittee Members for the extensive and thorough work the Subcommittee has conducted, over the past two years, on the unrelated business income tax. ... As you know, the unrelated business income tax has been in place since 1950 without effective Congressional oversight. ... As Chairman, I look forward to receiving a conceptual package of recommendations from the Subcommittee. Accordingly, you and the other Subcommittee Members are to be commended for the package of draft recommendations the Subcommittee has developed to date. I consider consolidation of the Subcommittee's work on the unrelated business income tax to be a priority matter....

All told, more witnesses and more Congressional attention was devoted to the issue of unfair competition in the last eight years than in the hearings that gave rise to the 1950 unrelated business income tax.

Of course, the small business complaints have found expression in other than Congressional hearings; including, most recently, the White House Conference on Small Business. One of the top 15 issues of all delegates to the White House Conference on Small Business conducted in 1995 and 1986 (the last two conferences) was unfair competition resulting from Governmental and nonprofit activities. According to the delegates' recent recommendation:

Support fair competition: *Congress should enact legislation that would prohibit government agencies, tax-and antitrust-exempt organizations from engaging in commercial activities in direct competition with small business.*[9]

[9] Report on the 60 Final Recommendations of the White House Conference on Small Business.

The issue of the proper treatment of nonprofit commercial activities is again at the forefront of policy debate. Extensive hearings before the Ways and Means and other Committees, written comments on discussion options released by the Committee,[10] and media coverage[11] have all elucidated the diverse and seemingly irreconcilable perspectives of the for-profit and tax-exempt communities. It should be borne in mind, that it is on the heels of this debate that the wealthiest non-profits, who cater to the wealthiest patrons, seek to relax the guidelines to dredge a safe-harbor for travel and tour promotion.

B. The Nonprofit Perspective

So what different perspectives control this debate? From the economic perspective, nonprofits do not believe they should be prevented from raising funds from commercial travel and tour operation. Operating a commercial enterprise in competition with for-profits virtually guarantees a means of fundraising. This is considered especially important in a period of *purported* down-sizing in Federal and corporate funding and increasing competition for donative sources of revenue.[12]

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[10] Ways and Means Committee Print 100-30, 100th Congress, 2nd Sess., (April 21, 1988). For example, many for-profits in the travel and tourism industry responded in written comments to the Subcommittee on Oversight's discussion options (*infra*) stated their concerns. For example, the American Bus Association stated that:

> *ABA members have faced increased competition from and have lost business to tax-exempt schools, colleges, universities, churches and other groups that provide bus tours and charter ... many ... are now providing tour and charter services to the general public or to tour groups ... the traditional market of tax-paying, commercial charger bus companies ... ABA supports [the Subcommittee's recommendation] for services that are part of a degree program, and those services are provided in furtherance of the tax-exempt organization's religious or educational functions ... ABA maintains that the exception for services provided as a part of a degree program should be carefully delineated.*

The American Society of Travel Agents, in an April 15, 1988 letter indicated as follows:

> *...UBIT should be imposed on those specified activities whose nature and scope is inherently commercial rather than charitable ... ASTA does not agree that a de minimus sales exception should be applied for non-students and faculty who purchase travel and tour services. ASTA supports exemption for a degree program curriculum ...*

[11] See, e.g. U.S. News and World Report, "Tax Exempt! Many nonprofits look and act like normal companies -- running businesses, making money. So Why Aren't they paying Uncle Sam?", pp. 36-51, October 2, 1995.

[12] Whether or not there has truly been a "down-sizing" of federal funding depends on how it is measured. Federal funding may not have kept pace with the explosive growth of non-profits but it certainly has not decreased.

Universities derive a significant percentage of their income from product and services sales. Four year private nonprofit institutions derived as a group 18.8 percent of their revenues from donations, as opposed to 51.9 percent from tuition, fees and other charges, and another 13.8 percent from government grants and contracts, between the years of 1986 and 1988.

From a philosophical perspective, universities and colleges in particular justify commercial activities for travel and tours by broadly construing the educational component of the 501(c)(3) exemption. The response of the University of Texas to the 1988 Ways and Means discussion options (as it describes its view of the 'educational experience') is instructive:

> *A significant part of a college education is based upon a student's extracurricular activities and his or her exploration of people and places which may not be at all related to the award of a degree. A university-related travel service should be able to provide travel assistance ... where the travel is related to any educational function of the university.*[13]

However, the current Treasury regulations consider education to include, with alarming generality, "instruction of the public on subjects useful to the individual and to the community."[14] Therefore, many universities maintain that travel and tour activities, simply because they are conducted by the tax-exempt, must be educational in nature. This point of view is integrated into the fabric of the proposed C&L guidance, which would give great deference to the university's conclusions as to the educational nature.

Still other nonprofits question whether the underlying complaints of small business. Some nonprofits question whether their activity competes with the for-profit sector at all,[15] or, if it so competes, whether the competition is "unfair." These nonprofits claim the business community is simply afraid of competition.[16]

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[13] See response to the discussion options of the University of Texas system, page 894.

[14] Regs. §1.501(c)(3)-1(d)(3).

[15] According to the comments of the American Association of Museums, in their response to the discussion options:

> *... we of only one passing reference to a museum that competed unfairly with a taxable busine*

For example, the Currier Gallery of Art, in their response to the discussion options stated:

> *We also offer a series of art related travel tours for our members. While we do not offer college credit for these trips, they are carefully designed to be educational. These tours provide our members an opportunity to study the arts in depth, under the guidance of qualified staff; they are in no way "sight seeing" tours and we do not compete with the travel/tour industry.*

[16] According to the Center for Nonprofit Corporations, in their response to the discussion options:

> *There is little dispute ... that competition ... has been increasing. But is this competition unfair. Statistics have not proven that non-profits enjoy an unfair competitive advantage over small businesses; furthermore small businesses themselves enjoy a number of tax benefits and preferential treatments ... In a society ... which has regarded competition as ... healthy, measures to diminish competition should not be enacted...*

Other organizations fear "accounting" problems stemming from enforcement of UBIT.[17] Other claim that there would be minimum revenue gain to the Treasury, at great costs to the organization.[18] Still, others believe the taxation of some activities will curtail or eliminate these activities.[19] Some equate taxation with a penalty.

And some seemingly apply a "destination" test rationale to balance the value of the revenues generated from non-taxed activity to the value of the revenues generated from eliminating the revenue foregone. For example, some tax-exempts state that exemption should extend to any activity where the organization serves the public interest. Since taxes remove resources from private hands to support broad public policy purposes, the argument goes, income earned by such an organization is appropriately exempted from tax.[20] The nonprofits view the enforcement activity of the Service as troublesome interference with their efforts to perform these public services. On behalf of these nonprofits, C&L complains the current enforcement is "not uniform", applies "inconsistent", "unclear", "unrealistic", "unpredictable" and "undesirable" standards that

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[17] According to the Columbus Museum, in their response to the discussion options, p. 315:

> *The proposed plan to change the UBIT seems ... an attempt to penalize those museums that have sought other means to generate revenue.*

[18] According to the Association of Art Museum Directors, in their response to the discussion options:

> *We are also concerned that the administrative accounting burdens which would be placed on the institutions appear to be tremendous, and this particularly should be considered in view of the modest impact which we believe all these options would have in raising tax revenues.*

According to the Association of Art Museum Directors, in their response to the discussion options:

> *Lastly, some ... have concerns with the application of the UBIT to ... travel and tour services ... We are deeply concerned about any erosion of income which these changes may cause.*

[19] For example, the Laguna Gloria Art Museum, in their response to the discussion options stated:

> *Travel services - While this is not significant income to us, Austinites must travel to places like ... Los Angeles to view important exhibitions ... [W]e are concerned that our tour prices not be prohibitive due to taxation of net income.*

The American Arts Alliance, in a somewhat inconsistent statement, said:

> *Special travel programs are ... used to ... develop new supporters ... and to provide an 'extra touch' to regular members services. To be taxed on the minimal amount of income such programs raise would force many institutions to drop travel services entirely.*

Their statement was echoed by that of the Brandywine Conservatory:

> *To tax the small revenues derived from travel services would almost certainly cause us to eliminate them.*

[20] See response to the discussion of Thomas J. Borby, Esq., p. 250.

"do not properly consider the educational nature of these travel tours in light of all the facts and circumstances".

C. The Small Business Perspective

Small businesses are placed in an awkward position. Small businesses recognize the essential work of many nonprofits; indeed, while not often publicized, small firms are the largest contributors to non-profits on an employee-by-employee basis.[21] However, small businesses vigorously oppose nonprofit unfair competition. They oppose both nonprofit entry into the markets traditionally served by for-profits, as well as nonprofit domination of markets where for-profits would like to provide services and for which no exemption is appropriate.

At the same time, for-profits recognize that the 'substantially related' test was enacted with one purpose in mind: to stop nonprofits from unfairly competing against them. However, they recognize that it has failed at this task. Businesses are acutely aware that the 1950 law meant to protect them is anachronistic, never intended to restrain the current scope and size of nonprofit commercial enterprises, and demonstrably unable to protect small firms from the vast commercial enterprises of nonprofits.[22] They are also concerned that the laws currently in existence are not adequately enforced. Businesses complain that the manifold abuses resulting from unfair competition cut across industries, and are neither "episodic, exaggerated or extraordinary."[23]

Furthermore, for-profits point out that the inability of the "substantially related" test to perform its protective function is evidenced by data which show that the size and scope of nonprofit commercial activity has increase disproportionately to their reported UBIT. In 1985, for example, the total tax revenue raised from nonprofits was $40 million, at a time when their gross receipts were $250 billion. In addition, in that year, a random audit of Forms 990-T revealed that one-third of had deficiencies in UBIT reporting of between 30 and 50 percent.[24] These data are supported by the coordinated examination program results.[25] The data, made manifest by the anecdotal cases, translates into a strong perception of unfairness.

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[21] See, SBA, Office of Economic Research study: Small Business Contributions to Public Service Organizations. Per, Ed Starr, Ph.D.

[22] Indeed, businesses point to the tax-code as the virtual font of other exemptions in securities laws, labor laws, postal subsidies, local and state property exemptions *et cetera.*

[23] See response to the discussion options of Joseph O'Neil, Chairman, Business Coalition for Fair Competition, p. 258

[24] See, "Tax Policy: Competition Between Taxable Business and Tax-Exempt Organizations," Briefing Report to the Joint Committee on Taxation, U.S. Congress, by the General Accounting Office, February 1987, GAO/GRAD-87-40-BR

[25] See Daily Executive Reporter, Taxation, Budget and Accounting, recently attributing the following statements to Marcus Owens, Director of the Service's exempt organization division: "IRS audited 12000 returns in the tax-exempt sector in fiscal 1993, yielding a change rate of 73 percent. Audits of 2,232 Forms 990-T yield a 79 percent change rate."

Added on top of this is small businesses circumspection of the extremely questionable rationale for any tax exemption for travel and tour promotion. Small businesses maintain that, as a starting point, nonprofits should not be provided an exemption for activities that the business community can do without the benefit of exemption. This viewpoint, is pivotal to the economic and tax policy justification of the exemption itself and echoes the concerns of the Department of Treasury:

> *Limits on the scope of such tax exemption are appropriate and necessary. This Nation has prospered through its reliance on private, market-based economy to supply necessary goods and services. The role of the government generally has been restricted to those socially important activities not adequately supported by the private sector. The role of the quasi-governmental, not-for-profit sector should similarly be restricted to that of supplementing, and not supplanting, the activities of for-profit businesses. Thus, tax exemption for public charities should be restricted to those areas where the quality or quantity of goods and services that would be produced strictly through market forces is inadequate.*[26]

It is also, as noted, consistent with the preliminary findings of the Ways and Means Committee during their policy deliberations.

For many small firms, the only discernible distinction between their activities and that of the nonprofit is that one pays taxes and the other does not. Travel and tour promotions are one of those inherently commercial activities for which no exemption should be extended as a matter of policy. More to the point, however, small businesses recognize that most nonprofits engaged in travel and tour services are not serving the traditional markets for which exemption would be required. Indeed, rather than providing the services to those that could not otherwise afford it, businesses point out, the exemption enables nonprofit travel and tour promoters to tap and maintain access to the high-end, most lucrative part of the market -- the segment with the greatest disposable income, the greatest number of professionals and the highest component of educated customers. When this competition occurs, there is a distinct and quantifiable competitive advantage nonprofits enjoy from total relief from the income tax.[27]

For-profit travel and tour providers and operators point out that application of the "educational" definition sought by the tax-exempts would qualify virtually anything, especially any tour, as educational without limitation. Businesses believe that many tour and travel activities are clearly not related enough to the exempt purposes; and are frustrated that there is little, by way of practical enforceable or objective tests for distinguishing what is pedagogical from what is not.[28]

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[26] Hearings before the Subcommittee on Oversight, Ways and Means Committee, June 22, 1987. Serial 100-26.
[27] *Id*
[28] In their response to the discussion options, the National Tour Association stated:

Perhaps most importantly, businesses agree with the Treasury, the Service[29] and the General Accounting Office,[30] that the current substantially related standard is vague and difficult for agents to enforce. According to testimony by then Assistant Secretary Don Chapoton:

> *Our primary concern with the 'substantially related' test is whether in practice it has been useful in distinguishing activities entitled to exemption, from those that are not. The general concepts enunciated in the regulations inherently require facts and circumstances determinations that are not likely to achieve consistency among different exempt organizations. The practical result appears to be an ad hoc test that, in may cases offers inadequate guidance to the courts, exempt organizations and revenue agents. Moreover, to the extent the relatedness standard has provided guidance, there are indications it has been applied in an overly generous manner. Some courts appear to have found the requirement ... satisfied when the activity contributed simply in some way to that purpose.*[31]

Businesses are painfully aware of the difficulties of uniformity in enforcement and accounting. However, businesses believe guidance to make matters uniform should not be achieved at the cost of deviating from current law. Small businesses do not understand why, when the UBIT has demonstrably and resoundingly failed to halt the tide of unfair competition, and when the enforcement has had admittedly mixed effect, that the nonprofits could then argue for an enhanced safe-harbor. In the context of travel

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> *We concur with the inclusion of [tour and travel services] among the services which are inherently commercial. We offer no objections to the stated exception regarding ... such services provided by colleges, universities to students/faculties as a part of a degree program curriculum ... this places the services in a direct relation to the purpose of the college or university and through providing the Service to the student /faculty eliminates the commercial nature of the services*

[29] According to then Commissioner, Lawrence Gibbs:

> *...application of the tax requires a very subjective decision that is based on the facts and circumstances of each case. Again, I will not go into them in detail other than to mention them and to express my opinion that they do cause administrative difficulties for the Internal Revenue Service. Specifically, whether an activity is or is not substantially related to an exempt purpose. Again, this has been a difficult area for us in making decisions that require an examination of the relationship between the income-producing activity itself and the accomplishment of the exempt purpose....*

[30] According to Jeannie Stathis, then Associate Director, General Government Division, U.S. General Accounting Office:

> *Administering this tax, can be difficult because of the individual circumstances that must be considered to determine whether an activity is substantially related to an exempt purpose. Id at p. 133.*

[31] At p. 28.

and tour activities, small businesses support more succinct guidance that will finally and definitively separate the classroom from the vacation.

II. The C&L Approach Summarized

The C&L proposal is premised on the goal of providing uniform standards for determining whether or not tour and travel services provided by 501(c)(3) organizations are "substantially related" and therefore exempt from federal income tax. The C&L proposal states that the Service is currently providing "inconsistent" and "unrealistic standards" for the tax exempt community to follow. Due to these unrealistic standards, they argue, the Service must adopt newer, clearer standards which will place the 501(c)(3) into a safe harbor of activity. Within this safe harbor, C&L maintains, the services performed by the non-profits will clearly and significantly contribute to the educational mission of their community.

To summarize the C&L approach, there ought to be four general categories of inquiry in the evaluation for the "substantially related" test. In evaluating the substantiality of the relationship we must ask: (1) is the tour is sufficiently linked to the organization's goals or mission?, (2) who organized the tour?, (3) is the tour marketed as a commercial or exempt tour?, and (4) what is the linkage between the operation of the tour and the overall educational mission?

For purposes of determining the linkage of the activity to the organization's goals or mission, C&L merely enumerates factors, indicating they are relevant:

- the organization has a mission statement articulating the relationship of tours to its exempt purpose.
- the tour is predominately educational, not recreational.
- the tours relate to an area of program focus.[32]
- the tour is designed to attract those interested in the organization's mission, which may include students, members and alumni.
- the tours offer information, contact with local experts, access to places or other opportunities linked to the exempt purpose.[33]
- the organization ensures that tours have an "expert or *other qualified person* to address the tour concerning a topic relevant to the tour's focus." [emphasis added]
- the number of tours are commensurate with the scope of the organization's other exempt activities.[34]

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[32] The organization clearly articulates the programs it seeks to enhance and the relevance to the programs of each tour.

[33] C&L provides a very broad example. According to C&L:

> *For example, tours that include as part of the trip information or sites not generally visited by commercial tour operators that allow the study of wildlife may further the educational mission of a conservation, environmental or other educational organization that conducts programs on natural history. [emphasis provided]*

[34] As discussed later, this criterion seems to say that a bigger wrong can make a right.

Endowment, 477 U.S. 105.[43] There, the Court held that: "The undisputed purpose of the unrelated business income tax was to prevent tax-exempt organizations from competing with businesses whose earnings were taxed." Similarly, in *U.S. v. American College of Physicians*, 475 U.S. 834:[44]

> *tax-exempt organizations were able to carry on full-fledged commercial enterprises in competition with corporations whose profits were fully taxable. Congress perceived the need to restrain the unfair competition fostered by the tax laws.*

In 1969, Congress reexamined the effectiveness of the UBIT, and found it wanting. Many of the unfair competition concerns that prompted the UBIT persisted unabated. In some instances, the UBIT was encouraging tax avoidance, in other instances, organizations not subject to the UBIT were still unfairly competing against for-profits. In response, the Tax Reform Act of 1969[45] substantially broadened scope of the unrelated business income tax, *inter alia*, extending it to social welfare organizations, churches and farmer's cooperatives.

B. Relevant Statutes

The Code describes in relatively broad terms the type of tax-exempt business income that is subject to tax. Section 511(a), for example, imposes a tax on the "unrelated business taxable income" (as defined in section 512) of every organization described in "sections 401(a) and 501(c)" as well as on "state colleges and universities."

According to section 512, the term 'unrelated business taxable income' means "... the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business."

Section 513 then defines the term 'unrelated trade or business' to mean

> *any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption under section 501 ... [emphasis provided].*

The operative phrase, of course, is that the activity must be 'substantially related' to the exempt function of the organization to escape taxation.

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[43] 91 L.Ed.2d 89, 106 S.Ct. 2426,2432.
[44] 838, 89 L.Ed.2d 841, 846, 106 S.Ct. 1591, 1594.
[45] P.L. 91-172, §121 (1969).

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C. Relevant Regulations

The regulations dimly illuminate the circumstances under which application of the UBIT is required. Regs. §1.513-l(d), for instance, provides that determining whether or not income is substantially related:

> *necessitates an examination of the relationship between the business activities which generate the particular income in question -- the activities, that is, of producing or distributing the goods or performing the services involved -- and the accomplishment of the organization's exempt purposes*
>
> *Trade or business is 'related' to exempt purposes, in the relevant sense, only when the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income) and it is 'substantially related' for purposes of section 513, only if the causal relationship is a substantial one*

Furthermore, under Regs. §1.513-l(d), where the production or distribution of the goods or the performance of the service does not "contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business." Moreover, where income is realized by an exempt organization from activities, which are in part related to the performance of its exempt functions, but which are conducted on a larger scale than is reasonable necessary for performance of such functions, the gross income attributable to that portion of the activities in excess of the needs of the exempt functioned constitutes gross income from the conduct of unrelated trade or business.

Through the regulations, we know that the UBIT is to be applied only where there is not a causal relationship or the causal relationship is not substantial, where the income does not contribute importantly to that purpose, or where commercial activity is conducted on a larger scale than is reasonable necessary.

D. IRS Pronouncements

The issue of whether the tour is substantially related to the organization's exempt purpose or primarily a vacation that is educational only in a broad sense is not explicitly addressed by statute. Indeed, the quantification of the "fun" factor versus the "educational" factor has proven to be difficult. Nevertheless, the Service has, in several Revenue Rulings, Technical Advice Memoranda, and Private Letter Rulings addressed particular factual scenarios.

1. Tour Activity Unrelated to the Exempt Purpose

Several key decisions by the Service elucidate the factors which, if present or absent, indicate taxability. For example, the Service has long taken the position that the task of merely arranging for travel is not educational, even if the tours are available only to students and faculty of a university. In Rev. Rul. 67-327,[46] for example, the Service held that a non-profit organization formed for the purpose of arranging group tours for students and faculty of a university to allow them to travel abroad (and which has no other activities) is not entitled to exemption from federal income tax under section 501(c)(3) of the Code. This ruling made clear that the arranging of tours is not, *per se* "educational" in the sense of improving or developing an individual's capabilities.

Likewise, in Rev. Rul. 78-43,[47] an association, working with various travel agencies, scheduled several tours annually to destinations around the world, mailed out promotional material, accepted reservations, and was paid a fee by the travel agencies on a *per* person basis, but did not engage in "education" within the meaning of Section 513. The Service found that by making available the travel tours in the manner described, the organization was merely furnishing a regularly carried on commercial service not substantially related to the educational purpose of the organization.[48]

In TAM 9540002, the IRS was presented with a nonprofit tour activity which was so commercial in nature that the Service prospectively invalidated the exemption. In doing so, however, the Service opined in *dicta* that, had not the commercial enterprise so tainted the organization, the activity would have certainly have been considered unrelated. Under the facts in TAM 9540002, a program was organized to supplement the efforts of the government through the United States Information Agency in broadening "understanding and friendship with people of other nations". The exempt entity was formed in 1957 in order to accomplish the objectives of the program through sports. Its stated purposes were to:

> *assist in promoting closer understanding and cooperation among the people of the United States in learning about other nations while encouraging other nations to learn about the United States' athletic capabilities, sports traditions, and history and enhance the cause of world peace by encouraging and assisting private American groups and organizations to promote international understanding through the development of new, and expansion of, present sports activities.*

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[46] 1967-2 C.B. 187.

[47] 1978-1 C.B. 164.

[48] Rev. Rul. 77-366, 1977-2 C.B. 192, held that a nonprofit organization that arranges and conducts winter-time ocean cruises during which activities to further religious and educational purposes are provided in addition to *extensive* social and recreational activities is not operated exclusively for charitable purposes and does not qualify for exemption under section 501(c)(3) of the Code. (Emphasis added). In contrast, Revenue Ruling 77-430, 1977-2 C.B. 194, held that an organization that conducts weekend religious retreats open to all Christian sects, at a rural lakeshore site at which the participants may enjoy the recreational facilities in their *limited* amount of free time without fee qualifies for exemption under section 501(c)(3) of the Code as operated exclusively for religious purposes. (Emphasis added.)

The largest of the programs during the years under examination were its golf and tennis tours. Through these programs, the exempt organization arranged foreign tours for teams of amateur American players. Individuals and couples paid significant amounts to participate in such tours. A typical golf tour cost $7,000 with participants visiting six cities in three weeks. In each city, participants were required to participate in at least one golf match, required practice rounds and official receptions.[49]

2. Tour Activities That are Substantially Related

The foregoing can be contrasted with a line of rulings in which the activity was found to be exempt because it was substantially related. In Revenue Ruling 69-400,[50] the Service held that a nonprofit organization that selects students and faculty members who are interested in a foreign history and culture and enrolls them at foreign universities qualifies for exemption under section 501(c)(3) of the Code. The ruling distinguished Revenue Ruling 67-327 on the basis that the tours conducted by the organization complemented classroom study of a particular country and so advanced education.

Revenue Ruling 70-534,[51] held that a nonprofit organization whose primary activity was conducting travel study tours that included courses on the culture of the United States, foreign countries, and nature studies taught by certified teachers is exempt. The ruling noted that the studies included lectures, preparation of reports, recitations, examinations, and the issuance of grades. Consequently, the organization instructed the individual in such a way as to contribute to the improvement and development of his capabilities.

In Technical Advice Memorandum 8034022, the Service was presented with the issue of whether or not the sponsorship of study travel tours by a museum were exempt from taxation. The Service held that "the absence of educational content in each of the tour programs is fatal to the causal relationship." The Service found such a relationship present in the TAM.[52]

In Technical Advice Memorandum 8115025[53], the Service arrived at what may be its most lenient decision on substantially related travel and tour programs. Under this TAM, a liberal arts college for men and women, organized under 501(c)(3) of the Code, sponsored travel and tours through a travel agency to many foreign countries as well as

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[49] The Service concluded the operation of the golf and tennis tours did not contribute importantly to the exempt purposes and would have generated unrelated business taxable income if the national office had determined that this activity was not already a bar to exemption.

[50] 1969-2 C.B. 114.

[51] 1970-2 C.B. 113.

[52] However, it is difficult to determine from this TAM the factual bases upon which the decision was reached, since the TAM removes much factual material from discussion. The Service, of course, is restricted in publishing TAMs from mentioning too specific factual bases that may alert others as to the identity of the taxpayer.

[53] January 2, 1981.

certain designations in the U.S. The participants in such tours consisted of students, faculty, alumni, staff and friends. As an added service, the tour presented members travel-related seminars, films, lectures and social events in connection with the trips and tours.

In support of its contention that its operation of travel tours was an educational activity and not subject to tax as unrelated business income, the college had qualified faculty members, who were specialized in the countries, customs and history of the regions, accompany the tours and offer lectures during the course of travel. Lectures on the areas visited were presented while traveling and seminars were also conducted before or following each trip. In certain instances, a certificate was given to each tour participant demonstrating attendance at the lectures, and tours are offered in connection with academic courses for which college credits were given. In the words of the Service:

> *Recent submissions by X indicate that its operation of travel tour arrangements are substantially related to its exempt purposes. Lectures are offered both before and during the tours. In a number of instances the tours are an integral part of the academic course of study. Faculty members who participate in the tours and who also act as guides have specialized expertise in the countries visited. By offering travel tours in conjunction with academic courses of study and by providing lecture series and qualified academicians as part of each tour, the activity is furthering its educational purposes.*

The Service found the operation of travel tours analogous to the situation described in Rev. Rul. 70-534, in which an organization conducting travel tours was found to be educational where it included courses of study as an integral part of its activities. However, this TAM represents the outer limits of the Service's exempt treatment.

Indeed the Service has more recently required a showing that the educational component is a *primary* purpose of the tour in question. For example, in Private Letter Ruling 8303013, in the case of an organization organized to increase knowledge of art, history, design, science and other topics, the Service noted that arranging tours would not in itself contribute importantly to the accomplishment of the organization's exempt purpose. The Service instead took the position that "[t]he absence of *primary* educational content in each of the tour programs is fatal to concluding that a causal relationship exists between the programs, and the purported exempt purpose of promoting education or religion." [emphasis added]

The requirement that the educational content of a tour be *primary* subjects the organization to a much more intense form of scrutiny and requires more detailed evidence in support of the position that the travel tour is substantially related to an organization's educational purpose.

In PLR 8303013, the Service was presented with the following issue:

Whether the sponsorship of study travel tours by B, exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code, which include classes on areas of travel before departure, professional museum staff study tour leaders, lectures by local experts and qualification of programs for university level credit constitutes unrelated trade or business within the meaning of section 513

Under the facts of the ruling, staff or members of other educational or cultural organizations proposed tours and evaluated the tours for the relationship of the tour with activities of the exempt organization. The tour involved lectures by qualified study leaders, and the tour was integrated with lectures or classes to provide an element of educational continuity.

After an itinerary was finalized, a professional tour operator, under contract, arranged for transport and accommodations. Tours were led by professional staff with expertise in the areas to be visited. Scholars from other organizations and lectures from the area to be visited often participated. Moreover, certain tours were arranged in conjunction with classes of a five to eight week duration offered. Some tours offered an optional two day lecture program by curators and specialists in advance of departure. In some instances, academic credits were awarded to participants who attended colleges and universities.

The Service found existing authority makes it clear that the arrangement of tours is not in itself an educational activity which furthers an exempt purpose.

The absence of primary educational content in each of the tour programs is fatal to concluding that a causal relationship exists between the programs and the purported exempt purpose of promoting education or religion. ... Without such a relationship, the sponsorship of each of the tour programs would fail to contribute importantly to an exempt purpose.

The B study tour programs combine a constant mix of professional tour leaders, daily lecturers, lectures by local scholars and experts, related classroom studies, trip visits available only because of B contacts, and possible university credits. The presence of these factors in B's study tours is sufficient to support the conclusion that a causal relationship exists between the study tours and B's exempt purpose of promoting education and diffusion of knowledge in the arts, science, history, and culture of our world. The existence of such relationship ensures that the tours contribute importantly to the exempt purpose of B. Accordingly, the tours are substantially related within the meaning of section 513(a) of the Code.

IV. The Coopers and Lybrand Approach Analyzed for Content and Administerability

A. The C&L Approach Would Deviate Widely from Current Guidance to Dredge a Broad and Deep Safe Harbor

The revenue proposal sets out its intended purpose thusly:

> *[to] provid[e] uniform standards which it hopes will provide more guidance for tax exempt organizations and a safe harbor that can be applied by Exempt Organization Examiners.*

The "Table of Leading Existing Guidance" in this section simplifies and summarizes the determinative factors in existing guidance. The Table is an attempt to compare and contrast the factors the Service has taken into consideration in determining the opposite outcomes of taxable and non-taxable activity. These factors are then compared with those advanced in the C&L proposal.[54]

When the factors in the *substantially related category* are compared with those absent in the *not substantially related category*, and again compared with the *C&L proposed factors*, two observations can be made. First, there exists a wide gulf between the facts presented in the published guidance where the Service ruled favorably for the nonprofits and the facts presented in unfavorable decisions. As a consequence, there is an undeniably wide gray area between published decisions finding taxability and non-taxability.

Second, the proposed C&L proposal would not standardize current authority. Rather it is inconsistent with existing guidance in both the formulation of standards and the application of those standards to determine the safe harbor. The C&L approach attempts to jettison the bulk of these requirements and substitute in their stead a panoply of inexact considerations and decidedly liberal tests that would be considered in determining whether the tour promotion activity fell within an undefined safe harbor. The C&L approach is an attempt to bring activities currently deemed taxable within the purview of a new poorly constructed safe harbor,[55] and would also carve a safe harbor out of the area now substantially lacking in authority.

The following table indicates which factors where present or absent when the Service found in the indicated Revenue Ruling or Technical Advice Memorandum that an activity was or was not substantially related. An 'X' indicates that the factor was present in the facts considered in the indicated guidance. An 'O' indicates that the factor was absent. The table also indicates whether we believe that factor may be present or absent in a commercially operated tour.

As the private letter rulings indicated *supra* and the preceding table indicate, a limited number of factors were present when the Service found the activity to be exempt from taxation. In all three rulings where the tour was substantially related, the tour was part of

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[54] The "Table of Leading Existing Guidance" set forth above summarize the primary factors that existing guidance has weighed in determining whether tour activity is exempt or taxable. However, comparison with the C&L approach is complicated by the fact the proposal does not ascribe any weight to the factors, as discussed *infra*.

[55] In contrast, the approach outlined in this submission is largely consonant with existing guidance and simply tries to clarify the analytical issues involved by creating an understandable regulatory framework by which the issues may be decided.

TABLE OF LEADING EXISTING GUIDANCE

X = factor present in indicated guidance
O = factor absent in indicated guidance

Factor Considered	Factors Present When Activity Found Substantially Related			Factors Present When Activity Found Not Substantially Related			Factors Present Comm. Tours
	Rev. Rul 70-534	TAM 8115025	TAM 8303013	Rev. Rul 67-327	Rev. Rul 77-366	Rev. Rul. 78-43	Commercial Tours
Classroom instruction lasted weeks	X	O	X	O	O	O	O
Tour part of a study program with courses related to area being visited	X	X	X	O	O	O	Perhaps
Library on tour	X	O	O	O	O	O	Easily Arranged
Graded Examination	X	O	O	O	O	O	O
Credits offered or provided	X	X	X	O	O	O	O
Tours conducted by teachers	X	X	X	O	O	O	Perhaps
Tours directed towards students	X	X	X	O	O	O	X
Study materials provided	X	X	X	O	O	O	X
Lectures	X	X	X	O	O	O	X
Reports	X	O	X	O	O	O	X
Tours at suggestion of staff or members	O	X	X	O	O	O	X
Tours evaluated by staff	O	O	X	O	O	O	X

a study program with courses related to the area visited, credits were offered or provided, tours were conducted by professors or experts, tours were directed towards students, study materials were provided and lectures provided. In two of the three, classroom instruction lasted several weeks, and required reports were due. Where there was not an actual examination and a library on tour, the tours were evaluated by faculty and staff and suggested by faculty and staff.

The bottom line of these rulings is that all cases in which the tour activity was found substantially related resembled a traditional classroom setting, where the student demonstrated a desire to learn and the university demonstrated a *bona fide* desire to impart knowledge, even to the point of testing the knowledge acquired. Of course, in these fact patterns the educational integrity was also backed up by the institution offering credit or providing credits for the "courses", effectively putting its credibility where its income is.

When the activity was not found to be substantially related, each of these factors were absent. In addition, the tours were also offered to the public.

What does the combined guidance of the Service really mean as a dispositive test? First, it should be obvious that when a commonality of factors align in the ruling to deny exemption, such factors, when present, should always cause the activity to be taxable. However, the absence of one or more of these factors are not dispositive as to non-taxability. Likewise, the rulings finding the activity substantially related do not stand for the proposition that the factors outlined within them are exhaustive as to non-taxability.[56] The only factor we know for certain must be present, is that the educational content must be "primary" for a causal relationship to exist. As a corollary, therefore, the absence of these factors alone are not exhaustive as to taxability. They merely mean that if these classroom indicia are not present, the existing guidance, both precedential and non-precedential, suggest that the activity will not be tax-exempt.

On the other hand, while not exhaustive as to criteria, the rulings clearly suggest that the Service has a fairly well established set of criteria under which it has found activity to be substantially related. Consequently, if a true safe-harbor is to be developed, it must at least require the nonprofit to demonstrate compliance with the factors found to be present in the rulings finding the requisite nexus. Does the C&L approach require these factors to be present for the safe harbor to apply? The answer is clearly no.

The proposed C&L codification of current authority is simply not consistent with the existing guidance where the activity was found substantially related. In the C&L's safe harbor, there is no requirement that these factors be present. Indeed, the proposed

[56] Because the Service found the presence of these factors to constitute a substantial relationship in an educational context, does not mean that other factors would not likewise be considered to be substantial related.

guidance liberalizes the actual educational content or opportunity required. For example, in test (5) of the 'Purposes and Content' section, C&L recommends:

> *[t]he tours offer information. For example, tours that include...information or sites not generally visited (sic) by commercial tour operators*[57] *...may further the educational mission [emphasis provided]*

Whether the tours "offer" or "include" information is an unjustifiably low threshold for determining that the tour imparts or ensures acquisition of knowledge. Could it be possible that the organization can "offer" information if it provides participants with a list of cites to publications currently available, a documentary film, or lecture that the participants will not read or view because they are preoccupied by sightseeing.

Test number (6) is also illustrative. While here C&L seems to build upon the requirements in current law that the program or tour offer lectures or guides that are experts, the C&L guidance expands on this requirement in the following way:

> *The exempt organization ensures that each tour has an expert or other qualified person to address the tour...the ...qualified person need not be affiliated with the organization, but it is sufficient that the organization, because of its reputation and contacts in a particular field can attract qualified experts with the necessary professional credentials...*

It is difficult to imagine a more ambiguous test. The failure of the tour to have available an expert should be dispositive as to the question of whether the tour is educational, but here the qualified person need not be an expert as long as the organization *can attract qualified experts*. The tests suggests that experts need not be available for the safe harbor to attach (a finding inconsistent with current guidance); rather, it is sufficient if the nonprofit can provide the possibility the organization can attract experts. If it can so provide this possibility, the tour is *ipso facto* educational. How does the ability to attract experts establish the educational content of the tour? If the tour attracted experts in the past, will this suffice to provide blanket non-taxability? How does C&L propose the Service enforce or verify this requirement?

Finally, we can look to test (8) which offers the following factor: "The number and scope of tours during the year is commensurate with the size and scope of the organizations other exempt activities." What does this mean? Certainly, rulings have found that the level and scope of commercial activities can be compared to the overall receipts of an organization as the Service questions the exempt status of an organization or the taxability of tax-exempt trade or business income (Reg. Section 1.513-1(d)(3)). This

[57] Furthermore, the insinuation of the test that sites not generally visited by commercial tour operators is not conclusive as the nonprofit activity may have simply driven out or otherwise prevented the emergence of for-profits.

does not mean, however, that exempt travel and tour activities, if small in comparison to all commercial activities, is exempted for purposes of determining if the substantially related test is met. If this is the suggested interpretation, this test introduces a sort of relative *de minimus* formula into the audit guidelines, which is wholly unacceptable as a means of rewarding large violators over small violators.

There is at least one other case where the organization would simply have to offer the educational content. In Part D, the Operation and Education Components, the following factors are favorable. "The tour participants are furnished with pre-tour reading lists," and that "[s]significant portions of time...are arranged to *allow* participation in the educational programs [emphasis provided]." However, nowhere is there a participation requirement, or any similar requirement, that the organizations could rely upon to ensure that its mission was being fulfilled.

C&L also deems marketing considerations helpful. In the 'Marketing' section of the proposal, C&L suggests that "marketing the tours primary to an interested target audience that has an established interest in the mission of the organization is favorable." Here again the relevance of the test is dubious. Of course the marketing will be to those that have an established interest in the mission. Marketing should seek to efficiently target the most likely consumer. By establishing the target audience as "members, student, alumni and others" the test would encompass virtually anyone who has contact with the organization. Moreover, it is important to note the test does not exclude marketing to the general public.

Finally, the factors would suggest that the organization's review of educational content is evidence that the tour and travel has educational content. According to "Tour Development", "[t]he organization establishes appropriate criteria for review". However, allowing the organizations to establish their own criteria, and internally and conclusively certify that the content of the tours complies with the educational mission of the school, does nothing to ensure substantial relationship. Indeed, it delegates decisions to non-profit organizations and precludes the authority of the Service to objectively analyze their motivations. It is indeed clear that the organization is not requiring as rigorous an academic review standard as it would do for the allowance of credit hours, or continuing education credits.

Without providing standards or factors previously supported by a revenue ruling or other authority, the factors have little or no use to the Service which must base a revenue procedure on current law or policy. They certainly do not fulfill their purported mission of standardizing the existing guidance.

B. The C&L Approach Introduces New Standards and Then Fails to Clearly Enunciate These Standards

Perhaps as important as the substantiation of new factual criteria, the C&L "guidance" posits no fewer than five new standards for determining the substantiality of the linkage between the activity and the exempt function. For example, C&L's guidance would forbid the Service from finding activity taxable if it *furthers* the exempt function, *relates* to the exempt function, is of *relevance* to the exempt function, is *linked* to the exempt function, or even does as little as *promote* the exempt function. Moreover, once these new standards are advanced, the proposal does nothing to clarify their meaning.

For example, in Section B of the attached C&L proposal, three factors are enumerated that "indicate that the travel tour program *furthers* the exempt mission". "Furthers", of course, is a new standard, and a much more lenient test that is contained in the statute or regulations. Under current law, the activity must have a "causal relationship" to the exempt purpose and that relationship must be "substantial", that is, it must "contribute importantly" to the exempt purpose of the organization beyond merely raising money.[58] Mere "furtherance" of some exempt function is too attenuated a connection to be a meaningful standard.

Likewise, in section D, the C&L proposal finds the "opportunity to learn through interaction with outstanding professionals, who *can relate* the program to the objectives and mission of the institution, is itself educational ..." By the choice of this wording, it appears C&L is suggesting that the presence of this test is dispositive as to the substantially related standard. However, again whether or not a program "can relate" to an exempt purpose is not the same as saying that program must "substantially relate[]". In fact, it is difficult to divine a less demanding standard than an expression of the mere possibility of the existence of a relationship.

Also, in section D(1), C&L suggests another factor to be considered is whether "the content of the tours is organized around a theme or subject of study relevant to the focus of the organization." Again, mere *relevance* to the "focus" of the organization is not sufficient. The program must be *substantially related* to the educational purpose. In section (A), a proposed factor is that "the purpose of the tours offered is predominantly educational, not recreational." Whether the tours are "predominantly" educational is not the issue. Introduction of the term "predominantly" does nothing to clarify whether the tour is substantially related. Moreover, if the tours are in part related to the exempt purpose of the sponsoring organization and if the tours are "on a larger scale than is reasonably necessary" to further the exempt purpose of the organization, then they are taxable under the Code.[59].

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[58] The "substantial" requirement may be viewed as analogous to the requirement in securities law that misrepresentations be "material".
[59] Regs. §1.513-1(d)(3).

In the 'Purpose and Content' section of the proposed guidance whether or not "the purpose of the tours offered is *predominately educational*, not recreational" is one of the prescribed tests. Apart from the obviously circuitous nature of this test, the term "predominantly" is again suggested as a substitution for the statutory term "substantially related", and is most likely meant to be a liberalization of that term. "Predominately" as regularly used in the Code, can mean the most significant motive or the primary motive, but need not be a "substantial" motivating factor if many factors are present.

To take another example, test (5) of the 'Purposes and Content' section suggests another factor is whether or not the activity is "linked":

> *[t]he tours offer information...linked to the exempt purpose of the organization. For example, tours that include...information or sites not generally visited (sic) by commercial tour operators...may further the educational mission.*

The insertion of the term "linked" would considerably liberalize the audit guidelines beyond what is "substantially related."[60] Also, whether it "furthers" the educational mission or not dilutes the test. The question under present law is not whether the activity "may further" the exempt purpose, but whether or not it "contributes importantly" to the exempt purpose.

Finally, the C&L guidance suggests that "Tour Development" is a favorable consideration if the tour is reviewed to determine if "it promotes the organization's exempt purposes." "Promotes" is the fourth test suggested by C&L and comes no closer to defining what is meant by substantially related.[61]

In the "Operation and Education Components" section, C&L suggests still another factor; if the "content of the tours is organized around a theme or subject of study relevant to the focus of the organization." Again, the "relevance" of a tour is not the correct standard of substantial relationship.[62]

C. The C&L Approach is Intrinsically Flawed Since it Provides No Means of Ascribing Any Priority to the Attributes of Exemption

Apart from the expansion of salient factors and the obfuscation the relevant standards, the proposed guidance fails to add clarity through clear and succinct methods of applying these standards. For example, the proposed guidance states:

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[60] The sword of Damocles was indeed linked by a follicle of hair, but no one would say that it was a "substantial" linkage.

[61] See discussion of regulations, *infra*

[62] On this standard, limitations on justifications are more a function of a lack of creativity. A trip to Disney World EPCOT Center may be relevant to engineers, or to sociologists.

> *The factors outlined in this document, if present, will conclusively establish that a travel tour program is substantially related to an organization's exempt purposes. Not all factors discussed must be present to draw this conclusion. However, the favorable factors will be weighted against the unfavorable factors to ensure that on balance the facts and circumstances are such that an educational objective related to the organization's mission is met.*

This paragraph is internally inconsistent and adds significant confusion. An *ad hoc* test that weighs the favorable and unfavorable factors is not consistent with a dispositive, objective test that purports to "conclusively establish" that a program is a substantially related if "the factors outlined in this document" are present.

Furthermore, an *ad hoc* test such as this would not conclusively resolve anything until the facts are determined and the factors weighed. However, the proposed revenue ruling enumerates at least 23 factors to be considered. Any test that involves weighing 23 factors offers limited practical value to those trying to administer or comply with the law. A primary example of the difficulty of such a test is the 20 common law factors contained in Circular E for differentiating between independent contractors and employees. The problems on classification issues here should serve as an object lesson which suggests that such a list should be avoided.

D. The Proposed Guidance Offers a Safe Harbor, But Fails to Elucidate the Shoals or to Address the Varied Factual Scenarios Within the Uncharted Waters

While the proposed guidance purports to provide a safe harbor, it fails to show what behavior or activity will imperil the exemption of the commercial activities. By providing no information on the number of factors that will render activity taxable and by ascribing no weight to the various factors, the proposed revenue ruling offers no practical value to the Service or to the business community for whose protection the UBIT was enacted. Nor, for that matter, does it offer much by way of practical guidance for tax-exempt organizations conscientiously trying to comply with the law. If clarity and uniformity in enforcement policy is the primary purpose of this guidance, one would think it just as important for the tax-exempts to understand the behavior that is strictly forbidden if taxation is to be avoided.

Equally important, the proposed guidance fails to describe the many factual scenarios that exist in the marketplace today. The proposed guidance, if accepted, would enlarge the acceptable conduct of nonprofits but it would not clarify the vast gray areas where no guidance is provided. Within this area, as C&L suggests, programs would "still be examined and considered under the 'facts and circumstances' test presently used by the Service. However, it is this gray area in particular, which is most deserving of guidance.

In addition to deviating widely from current standards for determining what is 'substantially related', the C&L proposal is flawed in approach primarily because it is

wholly designed from the narrow perspective of what will satisfy the nonprofit community, without taking into consideration the Service's perspective (what will best administer the UBIT) or the business community's perspective (what will ensure that the UBIT serves its underlying function of protecting against unfair competition). From this vantage point, many of the shortcomings of the proposed guidance can be explained.

E. The Proposed Guidance Fails to Address Areas of Abuse, Such as the Allocation of Expenses

One of the other issues that contribute to unfair competition, apart from the taxability or non-taxability of income, is the allocation of expenses. If a taxable commercial activity of a nonprofit is sharing space with truly exempt functions of the nonprofit, is rent imputed? Can the nonprofit travel and tour activity reduce taxable income by the allocation of unreasonably high levels of expense, when these expenses are really borne by the nonprofit?

The proper allocation of expenses is an issue as integrally woven into the issue of unfair competition as is the allocation of income. According to the Treasury Department in its testimony before the Ways and Means Committee:

> *With respect to the computation of the tax on unrelated business income, we suggest that the rules for allocation of expenses be clarified to reflect the appropriate relationship between an organizations exempt functions and unrelated activities.*[63]

If true guidance is provided, expenses should be one of the items such guidance eventually covers.

F. The Proposed Guidance Would Focus Primarily on Universities and Colleges, When Other Nonprofits Also Engage in Commercial Travel and Tour Activities That Compete With For-Profits

It is important to note that, while colleges and universities have been actively engaged in promoting commercial travel and tour businesses in direct competition with for-profits, they are by no means the only category of organizations that engage in such activity. Various churches, museums, trusts and foundations, for example, have also stepped up their commercial travel and tour services. True guidance must also delineate what activities by non-educational 501(c)(3)s should be taxable.

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[63] See, testimony of Assistant Secretary Don Chapoton, at p. 24.

V. A Revenue Procedure May Not Be the Appropriate Vehicle With Which to Resolve These Issues

These determinations involve the resolution of major questions of substantive law, not merely process. Accordingly, the Service should appropriately seek to resolve these issues through the promulgation of a regulation; or in the alternative, if the non-profit community seeks to advance individual factual scenarios, in the context of various revenue rulings. A cursory analysis of the safe harbors reveals that the C&L proposal would necessarily involve determinations of substantive law and not procedure. In addition, the questions presented are of a magnitude that the input of all affected organizations should be sought.

For example, the "Purpose" section of the proposed revenue procedure provides an accurate overview of the broad substantive scope intended by the rule:

> *This revenue procedure provides guidelines that determine whether a travel tour program which is operated by an organization ... is substantially related to the accomplishment of the organization's exempt purpose and is therefore not taxable as an unrelated trade or business.*
>
> *The factors outlined in this document, if present, will conclusively establish that a travel tour program is substantially related ....*

The proposed "Revenue Procedure" asks, in short, for the Service to provide extensive guidelines to "conclusively" determine, in the form of a safe-harbor, the tax treatment of nonprofits' tour and travel activities.

In Revenue Procedure 89-14, the Service set forth the objectives of, and the standards for, the publication of such revenue procedures in the Bulletin, and provided some definitional distinctions between revenue procedures and revenue rulings. The purpose for publicizing both revenue rulings and revenue procedures in the Bulletin is to promote uniform application of the tax laws by Service employees and to assist taxpayers in attaining maximum voluntary compliance by informing Service personnel and the public of National Office interpretations of the internal revenue laws, related statutes, treaties, regulations, and statement of Service producers affecting the rights and duties of taxpayers.[64]

According to the Service, a "revenue procedure" is:

> *an official statement of a procedure published in the Bulletin that either affects the rights or duties of taxpayers of other members of the public sector under the Internal Revenue Code and related statutes, treaties, and regulations or, although not necessarily affecting the rights and duties of the public, should be a matter of public knowledge [emphasis added].*

A "revenue ruling", on the other hand, is:

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[64] Reg. Section 301.7805-1(c); Rev. Proc. 89-14.

an official interpretation by the Service of the internal revenue laws and related statutes ... published for the information and guidance of taxpayers, Service officials and others concerns.... Rulings and other communications involving substantive tax law ... are published in the form of revenue rulings. [emphasis added]

The fundamental distinction between these two forms of guidance is that the conclusions expressed in a revenue ruling will be directly responsive to, and limited by, the pivotal facts as stated in the revenue ruling itself. The conclusions drawn in a revenue procedure, as it is supposed to be confined to procedural issues, are not fact-intensive.

As the Service knows, the difficulty of applying a generalized ruling to define the vague contours of the substantially related test, as is suggested by the nonprofit community here, is legendary. The nonprofit community itself claims that the enforcement efforts are not uniform in application. However, guidance attempting to answer the difficult question as to whether the tour being offered resembles a classroom structure of a university or simply resembles a vacation must account for the wide varieties of fact patterns with which the Service and the taxpayers are confronted. The attempt to provide a general rule without application of individual facts more closely resembles a legislative role in the form of a revenue procedure than a regulatory role. If the Service is seeking to provide such a generalized rule, the better form for such a rule-making is defined in the Administrative Procedure Act, where the rule can be sufficiently noticed and the Service can take the time to elicit, hear and consider the many comments of affected entities and establish a number of working examples to replicate these fact patterns.[65]

VI. Adoption of the C&L Approach Would Fail to Take Into Consideration Serious Tax Expenditure Effects of the Safe Harbor

It has long been a stated position of the Service that, when developing regulations and rulings, revenue impacts of the resulting guidance must be considered. In numerous instances, therefore, when adding clarity to the law the Service does, indeed must, consider the effects of it ruling on tax expenditures.

If the suggestions made in the proposed revenue procedure were followed by the Congress, significant revenue diminishment would occur, at a time when the Service is increasingly realizing the importance of enforcement efforts against recalcitrant non-profits. If the Service were merely to introduce a safe-harbor, and nothing more, it would substantially reduce the estimated receipts from taxes.

The most obvious diminution of tax receipts would result, of course, from the conveyance of taxable income of for-profit firms into the nontaxable income of nonprofits, as nonprofit compete unfairly but effectively for the same marketplace. Nonprofits will

[65] Reg. Sec. 1.513 describes numerous fact patterns. In addition, organizations contemplating a substantial activity that is neither clearly related nor clearly unrelated might consider applying for a private letter ruling. A favorable ruling will protect the activity from adverse action by a Service auditor.

crowd for-profits out of markets traditionally served by the for-profit travel and tour promoters. The same revenue diminution will occur as would-be entrepreneurs, or existing for-profit travel and tour providers and promoters are discouraged from entering into new markets, the profits from which would be subject to taxation. Since there is at least empirical evidence to suggest that the travel and tour promoters of nonprofits target the wealthier market participants, there is also reason to assume that the loss of revenue would be proportionately higher for the same activity.

VII. The Guidance Should Provide Clear Standards for the Determination of Taxability

The proposed rule ought to accomplish its purported mission of clearly delineating factors that definitely establish taxability. The rule ought to ask the following questions: (1) What factors will conclusively determine the activity to be taxable? (2) What factors will conclusively determine the activity to not be taxable? (3) In the absence of a conclusive determination as to taxability, what factors must be weighed to determine whether the activity is taxable? In other words, the proposed rule should define the reefs and perils of taxability.

The rule should promote compliance by enunciation of clear, understandable standards for taxability and non-taxability. The tests, criteria and factors in the rule should be substantive, enforceable, and objective (preferably susceptible to quantification). The tests, criteria and factors should not elevate form over substance or merely make the nonprofit comply with a few bothersome procedural requirements to satisfy these perfunctory tests.

The rule should provide the factors that if present or absent conclusively determine that the activity is taxable. The rule should also provide the factors that if present or absent conclusively determine that the activity is exempt. The rule must also seek to shed some light on the larger gray area between the bounds provided by conclusively taxable or exempt activity. This may be done in a manner consistent with Congressional intent by providing taxpayers with a rebuttable presumption of taxability if these items are not present. This presumption may then be rebutted by establishing that the factors relevant under the rule are present to a sufficient degree and with sufficient weight.

Guidance should be consistent with the clear intent of the Congress when it enacted the underlying statute to prevent unfair competition. In furtherance of this purpose, when the facts are not such that a conclusive determination may be made under the rule and, therefore, the facts and circumstances must be weighed, the presumption should be that of taxability. The tax-exempt institution should be made to rebut the presumption that the income is taxable because to presume otherwise is to thwart the purpose of the statute. To reduce the scope of uncertainty and promote compliance, the rule should provide as many specific examples of the application of these relevant factors to specific facts as reasonably possible

The rule ought to anticipate the primary areas of unfair competition by seeking the factual scenarios from the business community. The business community would be more than pleased to provide the Service with examples that it believes are indicative of unfair competition that should fall within the ambit of the unrelated business income tax. In addition, however, the Service should rely upon data provided by the 1988 revisions to the Form 990 and by audits to help identify specific areas of non-profit activity with considerable overlap with the for-profit community. In the case of travel and tour promotion, such overlap can occur in markets defined by the customer base, by the locale served and by the mode of transportation.

Finally, the rule ought to provide a mechanism for the consistent communication to the Service of business concerns -- *i.e.* a mechanism where businesses can complain about potentially unfair competition. The Service Coordinated Examination Program for exempt organizations indicates that one factor in determining whether a case qualifies is whether "colleges and universities [have] multiple operations" and the unrelated business income of the organizations are appropriate for audit review.[66] Nowhere, however, does input from the business community rise to the level of an expressed consideration or does the existence of unfair business competition enter into the case managers' considerations either to identify the targets for review or to focus the resources once those targets are identified.

Two areas where this might have been logically inserted are IR Manual 7(10)(18)7.3 and IR Manual Exhibit 7(10)(18)0-3. In IR Manual 7(10)(18)7.3(2) for example, to determine those "areas which should take priority in the examination" the agents are advised to review "newspaper articles, books, magazine articles and other data pertinent to the examination cycle" Since the very *raison d'être* of the UBIT is unfair competition, the IR Manual should take this purpose into account. This will not only help to identify major cases, it will help to efficiently focus resources on specific and offending business activity. When the ratio of commercial to donative sources of income reaches a certain level, then inquiries should be made to determine if the entity qualifies for an EO Coordinated Examination.

The existence of unrelated business income does not always signify the existence of unfair competition. Nor does the mere fact of competition always mean that the activity is unrelated to an exempt purpose. The existence of unfair competition should, however, be a critical factor in determining whether business income is taxable.

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[66] The CEP indicates the elements the case manager must identify are "those areas which should take priority in the examination". See IR Manual 7(1)(18)7.3. The unrelated business income tax and unrelated business income are areas for which an ESAIN (340 and 510) are provided See IR Manual Exhibit 7(10)(18)0-1.

Appendix II
An Alternative Regulatory Approach to the Issue of Travel and Tour Promotion Activities

Proposed and Temporary Regulations

Unrelated Trade or Business (Travel and Tourism)

BACKGROUND

This document contains proposed amended regulations under sections 513 of the Internal Revenue Code. These regulations relate to the federal tax treatment of income arising from the travel and tourism income of tax-exempt entities. The regulations are proposed to be effective upon publication of final regulations in the Federal Register. The temporary regulations published ___,1995 were effective ____, 1995.

EXPLANATION OF PROVISIONS

Internal Revenue Code section 513, defines the term 'unrelated trade or business' to mean "any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption under section 501 ..." Regulation §1.513-1(d) states that determining whether income is substantially related "necessitates an examination of the relationship between the business activities which generate the particular income in question -- the activities, that is, of producing or distributing the goods or performing the services involved -- and the accomplishment of the organization's exempt purposes". "Trade or business is 'related' to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income) and it is 'substantially related' for purposes of section 513, only if the causal relationship is a substantial one." In addition, "where income is realized by an exempt organization from activities which are in part related to the performance of its exempt functions, but which are conducted on a larger scale than is reasonably necessary for performance of such functions, the gross income attributable to that portion of the activities in excess of the needs of the exempt functions constitutes gross income from the conduct of unrelated trade or business."

In the context of travel and tour promotions by tax-exempt organizations, additional guidance is required to clarify whether or not particular activity is taxable.

SUMMARY OF REGULATION

This regulation delineates factors that if present or absent conclusively demonstrate that travel and tourism income of a tax-exempt entity is substantially related for purposes of Regs. §1.513-1(d). The regulation also provides factors that, if present or absent, conclusively demonstrate that travel and tourism income of a tax-exempt entity is not substantially related for purposes of Regs. §1.513-1(d). The regulation provides factors that, in the absence of a conclusive determination, may be weighed in light of the facts and circumstances to determine whether or not travel and tourism income of a tax-exempt entity is substantially related for purposes of Regs.§1.513-1(d). Finally, the regulation provides factors that determine whether the travel and tourism program of a tax-exempt entity is on a larger scale than is reasonably necessary for the performance of a tax-exempt entity's exempt purpose.

SPECIAL ANALYSES

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. Although this document is a notice of proposed rule-making that solicits public comments, the notice and public comment procedure requirements of section 5 U.S.C. 553(b) do not apply because the regulations proposed herein are interpretive. Therefore, an initial Regulatory Flexibility Analysis is not required by the Regulatory Flexibility Act (5 U.S.C. chapter 6). Pursuant to section 7805(f)(1) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

COMMENT AND PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably a signed original and eight copies) to the Internal Revenue Service. All comments will be made available for public inspection and copying in their entirety. Written comments must be received by ___, 1995. A public hearing is scheduled for ___, 1995. See Notice of Public Hearing Published elsewhere in this issue of the Federal Register.

DRAFTING INFORMATION

The principle author of these proposed regulations is _____. However, other personnel from the Service and the Treasury Department participated in their development.

LIST OF SUBJECTS

26 C.F.R. §1.513-1(d)

PROPOSED AMENDMENT TO REGULATIONS

This document would add a new 26 C.F.R. §1.513-1(d)(4)(v).

REGULATION

§1.513-1(d)(4)(v)

(v)(A) *Travel and Tourism Trade or Business Generally.*

A travel and tourism trade or business is not substantially related to an exempt purpose for purposes of section 513(a) unless a causal relationship (under paragraph (d)(2)) exists between the travel and tourism and the achievement of the organization's exempt purpose. The presence or absence of certain enumerated factors may conclusively demonstrate a causal relationship or conclusively demonstrate the lack of a causal relationship. In the absence of a conclusive determination regarding the existence or lack of a causal relationship, then the rebuttable presumption is that the trade or business is not causally related. However, the taxpayer may rebut this presumption by demonstrating by a preponderance of the evidence that a causal relationship exists.

(B) *Factors Conclusively Demonstrating Causal Relationship.*

The following factors, if present, demonstrate conclusively that a causal relationship exists between the travel and tourism trade or business and the achievement of the organization's exempt purpose:

(I) the travel is a required component in a course (within the meaning of the accrediting agency) providing credit at an accredited educational organization within the meaning of section 170(b)(1)(A)(ii);
(II) the travel is conducted by faculty of an educational organization within the meaning of section 170(b)(1)(A)(ii) and the primary purpose of the trip is to further the faculty member's professional knowledge within his discipline or to participate in other professional activities;
(III) the travel is conducted by a curator or other professional staff at an exempt museum and the primary purpose of the trip is to further the curator's or other professional staff members' professional knowledge of matters pertaining to the subject matter of the museum's exhibits or to participate in other professional activities.

Example (1) S, a student at U, an accredited University, enrolls in a credit course that requires travel to site X away from U as one of the conditions of satisfactory completion of the course work. U requires S to pay for the trip. The trip is causally related to the exempt purpose of U.

Example (2) F, a faculty member of U that teaches Q, an accredited University, purchases a trip from U to site X to engage in detailed study of the Q of X. The trip is causally related to the exempt purpose of U.

Example (3) C, a professional staff member at M, an exempt museum that exhibits E, purchases a trip from M to travel to site X to engage in detailed study of E at site X.

{Other examples should be added. They may address other types of exempt organizations or other fact patterns}

(C) *Factors Conclusively Demonstrating Lack of Causal Relationship.*

The following factors, if present, demonstrate conclusively that a causal relationship does not exist between the travel and tourism trade or business and the achievement of the organization's exempt purpose:

(I) The primary purpose of the trip is recreational, or
(II) The primary purpose of the trip is administrative or commercial

Example (1) P purchases a trip to X from T, a tax-exempt organization. The trip involves visits to various sites of cultural and historic interest. These sites are the same sites typically visited by commercial tour operators and the guides and the information provided is similar to those typically provided by commercial tour operators. The activity is not causally related to the exempt purpose of U because the primary purpose of the trip is recreational.

Example (2) P purchases a trip to X from T, a tax-exempt organization. While on the trip P makes various visits on administrative or commercial business. But for these administrative or commercial visits, P would not have purchased the trip. The activity is not causally related to the exempt purpose of U because the primary purpose of the trip is administrative or commercial.

Example (3) P purchases a trip to X from T, a tax-exempt organization. While on the trip P makes various visits on administrative or commercial business. This visits were the primary purpose of the trip. The activity is not causally related to the exempt purpose of U because the primary purpose of the trip is administrative or commercial.

{Other examples should be added. They may address other types of exempt organizations or other fact patterns}

The following factors, if absent, demonstrate conclusively that a causal relationship does not exist between the travel and tourism trade or business and the achievement of the organization's exempt purpose (provided that the organization is exempt by virtue of being an educational organization):

(I) The primary purpose of the trip is educational

Example (1) A is an alumnus of U, an accredited university. A purchased a tour from U to X. The tour will visit many historical and cultural sites. These sites are the same sites typically visited by commercial tour operators and the guides and the information provided is similar to those typically provided by commercial tour operators. The tour is not heavily scheduled. Large blocks of free time are available. The activity is not causally related to the exempt purpose of U because the primary purpose of the trip is not educational but recreational.

Example (2) Same facts as example one, but free time is limited and the days are heavily scheduled. The activity is not causally related to the exempt purpose of U because the primary purpose of the trip is not educational but recreational. The fact that a tour contains many visits or events does not change its character.

Example (3) Same facts as example two, but A is a student or faculty member of U. The activity is not causally related to the exempt purpose of U because the primary purpose of the trip is not educational but recreational. The fact that a tour is enjoyed by a student or faculty member does not change its character.

Example (4) Same facts as three, but faculty members of U with specialized knowledge of the history and culture of X and other experts provide extensive lectures before and during the tour about the historical and cultural significance of what the tour participants will see, reading materials are provided to the participants and the content of the tour is substantially different than the tours offered by commercial tour operators and guides. The activity may or may not be causally related to the exempt purpose of U. The factors outlined in paragraph (D) must be weighed to determine whether a preponderance of the evidence demonstrates that the presumption of a lack of causal relationship should be rebutted.

{Other examples should be added. They may address other types of exempt organizations or other fact patterns}

(D) *Factors to Be Weighed in the Absence of Conclusive Demonstration of Causal Relationship.*

In absence of a conclusive demonstration of the existence or lack of a causal relationship under paragraphs (B) and (C), then the rebuttable presumption is that the trade or business is not causally related to the organization's exempt purpose. The presumption may not be rebutted unless it is factually shown that the sites and experts or tour guides in the tour are not substantially similar to those provided by commercial tour operators. Upon this showing, the following factors shall be weighed in light of the facts and circumstances to determine whether a preponderance of the evidence demonstrates that the presumption should be rebutted.

The following factors tend to rebut the presumption:

(1) a substantial portion of the tour consists of mandatory classroom lectures before and during the tour;
(2) a library is made available and used during the tour;
(3) a graded examination is administered or other objective demonstration of achievement is required of participants;
(4) the tour is conducted by faculty at an accredited University who have expertise in the subject matter or geographical area of the tour;
(5) substantive study materials are provided to the participants;
(6) activities performed by the tour participants contribute importantly to the base of knowledge in a field of knowledge;
(7) the marketing of the tour is limited to students;
(8) the content of the tour is approved by University faculty as being substantially educational in content.

The following factors tend to support the presumption:

(1) blocks of free-time or blocks of time devoted to recreation or entertainment are provided during the tour;
(2) an insubstantial portion of the tour consists of mandatory classroom lectures before and during the tour;
(3) no library is made available and used during the tour;
(4) no graded examination is administered or other objective demonstration of achievement is required of participants;
(5) the tour is conducted by persons other than faculty at an accredited University who have expertise in the subject matter;
(6) no substantive study materials are provided to the participants;
(7) activities performed by the tour participants do not contribute importantly to the base of knowledge in a field of knowledge;
(8) the marketing of the tour is directed at the general public;
(9) the content of the tour is not approved by University faculty as being substantially educational in content.

Example (1) P purchased a tour from U, an accredited university, to X. Tours to the site are not provided by commercial tour operators. X is an important archeological site where faculty of U are conducting excavations to uncover artifacts. The general public is not permitted to dig at X. P will participate in the excavations supervised by the faculty of U during all weekdays, participate in lectures before and during the tour and is required to read study materials and demonstrate his familiarity with those materials in order to participate. No particular provisions are made for recreation or entertainment in the tour but evenings and week-ends are free. The excavation is expected to contribute importantly to the understanding of the history of early X. The facts show that the sites and experts in the tour are not substantially similar to those provided by commercial tour

operators. Factors tending to rebut the presumption against a causal relationship outweigh the factors tending to support the presumption.

Example (2) P purchased a tour from M, an exempt organization, to X. The tour will visit many historical and cultural sites. The sites and tour guides in the tour are substantially similar to those provided by commercial tour operators. Therefore, the presumption against a causal relationship is not rebutted.

Example (3) P purchased from U a tour of the ancient cultural sites of X. Commercial tour operators do not offer tours of the ancient cultural sites of X (but do provide resort accommodations at the beaches of X). Commercial operators have no guides or experts in the ancient cultural sites of X. The tour is heavily scheduled. Substantive reading materials are provided to participants. Large blocks of free time are not available but large blocks of time are provided for recreational and entertainment activities. A library is made available and used during the tour to participants. No examination or other objective demonstration of achievement is required of participants. Classroom lectures are provided for the benefit of participants who wish to participate during the tour. The tour is not conducted by faculty of U. The facts show that the sites and experts in the tour are not substantially similar to those provided by commercial tour operators. The activity is not causally related to the exempt purpose of U because the factors tending to rebut the presumption against a causal relationship do not outweigh the factors tending to support the presumption. The fact that study materials and classroom lectures during the tour are provided to participants and that a library is made available to those wishing to use it does not outweigh the facts that U faculty are not conducting the tour; that mandatory classroom lectures were not provided prior to the tour, that significant blocks of time are made available for recreational and entertainment activities; no examination or other demonstration of achievement is required and the activities performed by the tour participants do not contribute importantly to the base of knowledge in a field of knowledge.

{Other examples should be added. They may address other types of exempt organizations or other fact patterns}

{In addition, detailed rules on expense allocation should be provided}

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The Bel Air Athletic Club

August 15, 1996

The Honorable Jan Meyers
Committee on Small Business
U.S. House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Madame Chair:

Please submit this letter into the official record of the House Committee on Small Business Unfair Competition Hearings held on July 18, 1996 so that I may respond to the question Representative Jackson raised. His question suggested that all fitness facilities of the Young Men's Christian Association (YMCA) deserved tax-exempt status because the Y's interest in promoting health came long before the private sector even considered health to be a factor or profitable.

The YMCA has existed for a long time and many of its facilities deserved tax-exempt treatment because they serve low-income families and needy populations, but I urge you not to confuse the Y's past with its present. The YMCA has changed with the times, as it should, but when you look at the entire spectrum of Y programs and facilities, you can't help asking: Has the Y gone too far in pursuing the commercial fitness market? Today's YMCA seems to have embarked on a plan that moves its fitness facilities out of urban low-income areas into the wealthier suburbs. I can't imagine, for example, that you would support a tax exemption for a YMCA fitness facility in a community like Reston, Virginia. At least 20 health clubs currently operate in that area, enhancing the physical health of the community, while building the community's tax base.

YMCA representatives justified their plans to build a tax-exempt health club in one of the richest counties in the country because they could use this suburban facility to make money for other programs, but the courts have ruled that the "destination of income" test is not a sufficient justification for tax exemption. The facility itself must have a charitable purpose. Not only is it likely that the Reston Y will serve very few disadvantaged persons, but from a public policy standpoint, Congress and the IRS should be asking if we want charities competing directly and unfairly for markets that can clearly be served by the tax-paying private sector.

Many YMCA facilities charge commercial rates not subsidized membership fees to use their health and fitness facilities and in many of these facilities members represent primarily upper - and middle income households. This stands in stark contrast with, for example, The Boys and Girls Clubs of America. In recent years, the YMCA has generated so much revenue from membership fees that they are now the largest U.S. charity with $1.9 billion in annual gross tax-exempt revenues. Seventy-eight percent of the Y's revenues currently are from fees.

658 Boulton Street, Bel Air, Maryland 21014 • (410) 838-2670 / 879-7115 • Fax (410) 893-0278
Four Sports, Inc., T/A The Bel Air Athletic Club

The Honorable Jan Meyers
August 15, 1996
Page Two

The *Nonprofit Times* wrote (November 1995): "The YMCA topped the *Nonprofit Times* 100 (biggest charities). Movement in the top 10 is extremely difficult since. . . only big increases -- hundreds of millions of dollars -- can create upward or downward shifts. The Y's jump of two full spots (since the prior year) is all the more amazing in this statistical context."

The fact is that all health clubs -- commercial ones, Ys and nonprofit hospitals -- play a role in promoting "health" but that doesn't mean we should be tax exempt. Since we opened the Bel Air Athletic Club in Harford County, Maryland, we have dedicated ourselves to improving the health of our community while building a strong and profitable club that contributes jobs, taxes, and significant support to Harford County's nonprofit organizations. If tax-exempt health clubs, be it the YMCA or a hospital fitness center, are exempt from taxes because they promote health, then most commercial health clubs in the country should be exempt as well. This is not a logical conclusion from a common sense or legal standpoint. The Court, in Sioux Valley Hospital Association v. South Dakota State Board of Education, rejected the promotion of health as the rationale for granting tax-exempt status to the Sioux Valley Hospital fitness club, stating that if they did then "if the cafeteria provided health foods related to maintaining a state of soundness of mind and body, the cafeteria would be tax exempt. Again, if the pro shop items (were) used for general fitness, which related to maintaining a state of soundness of mind and body, the pro shop would be tax exempt."

I think you will agree that simply being first does not entitle one to tax-exempt status. The mission of organizations change. Markets change. Societies change. Sadly, some YMCA's have significantly strayed from their much needed social service mission. The crucial issue is whether today's Y is a truly charitable organization or a commercial business when its primary constituency does not represent a charitable class. A legitimate question for Y staff and volunteers, Congress, and the public at large is, "What should be the primary focus of the YMCA -- the nation's largest charity -- for the remainder of this decade and the next?"

Sincerely,

Roger S. Ralph
President, Bel Air Athletic Club
Chairman, International Health, Racquet & Sportsclub Association's
Fair Competition Committee

RSR/tlh

The YMCA.

We build strong kids,
strong families, strong communities.

House Committee on Small Business
Hearings on Unfair Competition

Statement by CJ VanPelt
Director of Public Policy
YMCA of the USA

Honorable Jan Meyers
Chair, House Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515

Madam Chair and Members of the Committee:

The Small Business Committee held two days of hearings in mid-July on the issue of "unfair" competition by government and tax-exempt organizations. In the course of the hearings, two witnesses specifically complained about "competition" from YMCAs. I am deeply concerned about the committee's failure to include representatives from the nonprofit sector at these hearings. There is more than one side to any story and I believe the committee would have benefitted, as it did two years ago, from a more balanced presentation of the "unfair competition" issue.

This statement is submitted by the YMCA of the USA on behalf of the more than 2100 volunteer-led YMCAs that serve communities across the United States. I ask that it be included in the hearing record.

YMCA of the USA • Public Policy • 1701 K Street, N.W., Suite 903 • Washington, D.C. 20006
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YMCA Mission: To put Christian principles into practice through programs that build healthy spirit, mind, and body for all.

YMCA Child Care

Testifying at a hearing on July 16, a witness for the National Child Care Association criticized the provision of child care both by YMCAs and by public schools. She specifically cited a child care program operated by the Greater Burlington (Vt.) YMCA at a federal government site as one that was competing unfairly with her privately owned child care center. The witness argues, as others have in the past, that public and nonprofit child care programs should be restricted to serving only those children that nobody else wants.

YMCAs do not agree. YMCAs offer child care programs to meet community needs and because strengthening families and meeting the needs of children has always been central to the YMCA mission of building healthy bodies, minds, and spirits for all. Their commitment to serving children and families led YMCAs across the country to respond quickly and energetically to families' rapidly growing need for affordable, high quality child care. Collectively, YMCAs are now the country's leading provider of school-age child care.

YMCA child care programs have as their goals:

- supporting and strengthening the family unit;
- helping children develop their fullest potential; and
- delivering child care in a positive YMCA environment of safety, support and care.

One important way that YMCA child care programs differ from those offered by businesses is our commitment to making safe, quality child care available to children of working parents regardless of their ability to pay. YMCAs work hard to keep their fees low and to provide financial assistance to those who need it. As in other YMCA programs, those who can afford to pay a fee do; those who cannot receive help. Another difference is that the YMCAs commitment to serving all children leads them to welcome children

YMCAs commitment to serving all children leads them to welcome children who are more difficult to serve and who are often rejected by profit-oriented providers.

These difference are exemplified by the operation of the YMCA child care center at the INS facility in St. Albans Vt., the facility the witness cited as competing unfairly with her private child care center. The Greater Burlington YMCA provides financial assistance to three of the twenty-five children who attend the center. In addition, it charges a special, lower rate to another three children whose fees are subsidized by the state of Vermont. Finally, two other children attending the YMCA center have disabilities and emotional needs that make them harder to serve: one child has an individualized education plan that the YMCA child care center must follow; the other was placed with the YMCA by the state's foster care program. In other words, almost one-third of the children the YMCA serves at this "competing" facility are from low-income families or difficult to serve.

YMCAs also offer high quality child care. Contrary to the statement of the witness from the National Child Care Association, the YMCA's child care facility at the INS St. Albans site is fully licensed. The only waiver the facility received was permission to open and operate for three weeks without an outdoor play area. This three-week waiver came about because special, and very expensive, rubberized material needed to cover the playground failed to arrive on schedule. During the three weeks that the YMCA waited for this material to arrive, the child care center used local parks and playgrounds. In fact, this YMCA child care center not only meets all state licensing requirements, it exceeds them in critical areas, such as by having more staff in all classrooms than the minimum established by the state.

The YMCA is a place where children of all economic levels, from the affluent to the disadvantaged, receive the same quality care in the same setting. Absent the efforts of nonprofit charitable child care providers like YMCAs, child care would break down into commercial programs, which serve only those who can afford to pay, and taxpayer-funded programs, which serve only the disadvantaged. Moreover, the scarcity of taxpayer-funding would lead to an increase in the number of latchkey children. All child care programs, including

those offered by the Greater Burlington YMCA, help bridge this gap by serving the whole community, carrying out the YMCA's fundamental mission of providing services to all.

Finally, YMCA child care programs benefit the community by helping children develop a strong set of values, by fostering their confidence and self-esteem, and by encouraging regular physical activity. YMCAs' reputation for providing quality community-oriented programming has led school systems, government agencies, and private nonprofit organizations all over the country to ask YMCAs to assume the role of child care provider. All YMCAs, including the Greater Burlington YMCA, are proud of these partnerships.

YMCAs believe that nonprofit child care provides an important alternative to child care offered by businesses. Restricting charities like the YMCA to serving only the poorest and neediest children would undercut the substantial contribution that YMCAs make to their community and deprive parents of the ability to freely select the kind of child care that meets their family needs and reflects their family values. Well-managed, profit-oriented, child care centers coexist successfully with YMCAs in communities across the nation, as they have for many years.

YMCA Fitness Services

Roger S. Ralph, representing IHRSA, the International Health, Racquet and Sportsclub Association, testified at the July 18 hearing. Mr. Ralph also argues that charities should be restricted to serving only those who cannot afford to buy services from commercial businesses. We would like to set the record straight on several points made by Mr. Ralph.

First, YMCAs are community service organizations, not fitness clubs. YMCAs are one of the oldest, and largest, nonprofit community service organizations in the country. Founded in Boston in 1851, and dedicated to translating Christian values into practical action, YMCAs have responded to the needs of each new generation with a succession of innovative programs and services.

The YMCA mission can be summed up in just eight words: "We build strong kids, strong families, strong communities." YMCAs accomplish this mission through a broad range of programs for people of all ages. Unlike most health clubs, 50% of those using the YMCA are under the age of eighteen. Another 8% are over the age of 65.

The YMCA's emphasis on kids is reflected in the fact that the most widely available program at YMCAs is youth day camp. Most of the fastest-growing programs at YMCAs also involve children and young people, including programming geared at teens, school-age child care, and mentoring programs for minority youth.

Second, adult fitness is part of the YMCA's historic mission. YMCAs have been promoting health and fitness for adults for nearly 150 years. YMCAs began opening gymnasiums in the 1850s. The superintendent of the Boston YMCA gymnasium coined the term "body building" in 1876 and developed a fitness program that consisted of exercises that could be taught by largely unskilled leaders. The YMCA movement gave basketball and volleyball to the world. By 1901, there were 450 YMCA gyms in YMCAs across the country and by 1916, 911 YMCAs reported athletic programs and exercise. The first YMCA indoor pool opened in 1885 and YMCA methods for swim instruction became the standard in learning how to swim.

Today, YMCA adult programs carry on this tradition by helping over seven million Americans develop the physical, mental, and spiritual strength and self-confidence to be more effective parents, workers, and citizens. Through comprehensive, medically-sound, wellness programs, such as physical fitness, nutrition and weight management, stress management, and substance abuse prevention, YMCAs help participants clarify their values and live healthier lives.

Third, YMCAs earn their tax exemption every day by providing services that benefit their communities. Private athletic clubs offer some of the same services that YMCAs do, but few offer the YMCA's wide mix of services, most serve only adults, and none that we know of makes a practice of offering financial assistance to those who cannot afford to pay. Family-oriented

YMCAs meet community needs through such programs as pre-school and school-aged child care, summer and vacation day camps, youth memberships, programs for older adults, and activities for individuals with special needs. YMCAs also serve a broader range of people than most health clubs because YMCA financial assistance policies make sure that no one is turned away simply because they cannot pay.

YMCAs help communities by preventing problems—such as youth crime—before they become chronic and require costly government intervention. YMCAs work with troubled youth referred by school administrators, courts, and the police. They help public high schools by providing child care for school age mothers. They offer programs for at-risk youth, such as teen pregnancy prevention and substance abuse programs. YMCAs also work with other community-based organizations, providing meeting rooms and recreational opportunities for churches, for other youth-serving organizations like Big Brother/Big Sister and the Boys and Girls Clubs, and for a wide variety of other groups.

For well over one hundred years, the courts and legislatures of all fifty states have agreed that YMCAs earn their charitable tax exemption. Three recent decisions from appeals courts in three different states affirm that YMCAs continue to meet stringent state standards for charitable property tax exemption. All three of these cases directly addressed the issue of unfair competition and all found for the YMCA. The California Court of Appeals upheld property tax exemption for the Oakland YMCA's downtown facility against a challenge by the Clubs of California for Fair Competition. *Clubs of California for Fair Competition v. Kroger*, 7 Cal.App.4th 709, 720-721 (Cal. App. 1992). The Oregon Tax Court upheld the reinstatement of tax exemption for the Portland YMCA's downtown facility against a challenge by the Northwest Alliance for Market Equality. *Northwest Alliance for Market Equality v. Young Men's Christian Association of the Columbia-Willamette,* No. 3236 (Or. Tax Ct., Dec. 7, 1992). Finally, the Iowa Supreme Court affirmed that a YMCA child care center is charitable, a case that began with a complaint from a for-profit competitor. *Camp Foster YMCA v. Dickinson County Board of Review,* 503 N.W.2d 409 (Iowa, 1993). Following complaints by health clubs, numerous

other local tax officials have reviewed YMCAs' tax exemptions and have concluded that YMCAs continue to deserve their charitable tax exemptions.

Fourth, YMCAs are real charities. The mission of some charitable organizations is to serve the poor. Others, like the YMCA, while deeply committed to serving the disadvantaged, provide a framework within which people from all walks of life can come together for the common good. People in more advantaged circumstances are challenged to come to grips with the broader needs of the community, and to give time and money to help those less fortunate than themselves. Conversely, people from disadvantaged communities are pulled into a mainstream organization that helps them escape social isolation. YMCAs do not agree that there should be one set of facilities for the affluent and another that is restricted to serving the poor.

Many charities, not just YMCAs, earn part of their revenue from fees and dues. Colleges and universities receive a substantial amount of their support from tuition charges. Hospitals, nursing homes, and other health care facilities are largely supported through fees. Charging fees to those who can pay allows YMCAs to preserve charitable contributions for the benefit of those who cannot. As a Nebraska court once wrote, charity "include[s] practical enterprises for the good of humanity operated at a moderate cost to those who receive the benefit[s]." *YMCA v. Lancaster County*, 106 Neb. 105, 182 N.W. 593, 595 (1921). The definition of unfair competition advocated by Mr. Ralph, and the restrictions that definition implies, would radically alter the role of charities in American society.

Fifth, their tax-exempt status means that YMCAs are subject to obligations that no businesses must meet. YMCAs must make their services available to a wide cross-section of the community by offering financial assistance and by subsidizing programs to keep them affordable. All of the YMCA's programs and services must carry out the YMCAs' charitable mission of building healthy bodies, minds, and spirits. Any surplus at the end of the year must go back into the YMCA to carry on our charitable purpose. Finally, the assets of a YMCA are dedicated irrevocably to a charitable purpose and may not be used for the private profit of any YMCA volunteer or staff member. No one can own a YMCA and no one can profit from one.

YMCAs keep membership dues and program fees low in order to maximize the number of people who can benefit from the YMCA, not to drive private health clubs out of business. Accessibility and affordability are key issues in efforts to increase the number of people who participate in regular physical activity. The Surgeon General's 1996 report, *Physical Activity and Health*, tells us that regular physical activity reduces the risk of premature mortality in general, and of coronary heart disease, hypertension, colon cancer, and diabetes mellitus in particular. Physical activity also improves mental health and is important for the health of muscles, bones, and joints.

Yet, the Surgeon General also reports that more than 60 percent of American adults are not regularly physically active and 25 percent are not active at all. Even worse, nearly half of American youths between 12 and 21 are not vigorously active on a regular basis. Physical activity declines dramatically during adolescence. The YMCA's goal is to support and encourage all members of the community in undertaking the regular physical exercise that will help them lead healthier lives.

Sixth, adult fitness is an integral part of the YMCA, not a separate business. IHRSA keeps trying to isolate YMCA programs that are geared toward adult fitness from everything else that the YMCA does. This is an artificial and unrealistic distinction because adult fitness is one part of a larger whole, not a separate activity divorced from the YMCA's other programs. The YMCA's mission, to improve body, mind, and spirit, is a lifetime process. One way the YMCA accomplishes its mission is by offering the YMCA as a place to join for life. From a six-week old in a YMCA child care program, through an eighty-six year old in a "Young at Heart" water exercise program, the YMCA has activities for people at every age.

The way that YMCAs operate their programs underscores the point that adult programs are an integral part of the YMCA. As the California Court of Appeals found, adult activities are carried on in the same building as youth programs, share most of the same rooms and equipment, are directed by the same staff, share many of the same sources of financial support and share the same overhead costs. Moreover, as the court also said, YMCA programs interact with each other in a synergistic manner. YMCAs are "a complex of

related activities rather than a collection of discrete programs." *Clubs of California for Fair Competition v. Kroger*, 7 Cal.App.4th 709, 720-721 (Cal. App. 1992).

Seventh, YMCAs are not aggressively expanding fitness centers. Some of the 31 YMCAs chartered in 1995 are child care centers, some are teen centers, some are camps, some are store-front operations, and some are new family YMCAs. A family YMCA, which generally includes a gym, a pool, and space for exercise, education, and other programs, serves people of all ages. Surveys at local YMCAs show that young members use the YMCA more frequently and more intensively than their adult counterparts, contributing to the overall family atmosphere that characterizes YMCAs. Many newer YMCAs are setting aside space for teen centers and other programs geared to teens in response to growing community concerns about teen substance abuse and gang participation.

Revenue from membership dues, which support all YMCA activities, not just fitness, is growing. But, over the past four years, YMCAs' greatest growth in revenues has come from government grants and contracts (which mainly support child care for poor children and YMCA shelter programs), child care fees, and receipts from annual fundraising campaigns. These are not the indicia of an aggressively expanding adult fitness operation.

Understanding YMCA growth and income data also requires some perspective on how YMCAs are organized. While the YMCA of the USA collects and reports aggregate information about YMCAs, the YMCA movement is not a centrally-controlled corporate monolith with a $2 billion annual income. Rather, the YMCA movement in the United States consists of over 900 local, autonomous corporations, some of which operate more than one branch YMCA. The total number of chartered associations is over 2100. As long as they adhere to the general guidelines of the YMCA charter, the volunteers that lead each of these YMCAs are free to make their own decisions about how to serve their communities.

Seventh, YMCAs welcome the opportunity to cooperate with businesses. YMCAs work with business all the time and have been doing so for more than

a century. Cooperation among private businesses, nonprofits, and the government is the only way to solve our country's critical health and social problems. Small business leaders serve as volunteers on YMCA boards across the country. They also volunteer in YMCA programs and give money to support the YMCA's work. Small businesses support the YMCA because they appreciate the Ys' practical, close-to-home approach and their effectiveness in providing experiences that help people lead productive lives.

In conclusion, we believe that YMCAs earn their tax exemption every day by meeting community needs. Nobody owns a YMCA; nobody profits from one. The community receives the benefit of YMCA tax exemption through low-cost, high-quality programs that are accessible to all, not just those who can afford to pay.

Sincerely,

C J. VanPelt

CJ VanPelt
Director of Public Policy

THE HEALTH & FITNESS CONNECTION

EXECUTIVE HEALTH CLUB FOR MEN & WOMEN

August 5, 1996

The Honorable Jan Meyers
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Madame Chairman,

Please submit to the House Small Business Committee for its official record regarding the unfair competition hearings held in July. Unfair competition impacts our club in a negative manner. When the local YMCA has the competitive advantages associated with being a tax-exempt fitness facility, we experience loss of revenue and a decline in membership. Tax exempt encroachment into the market harms taxpaying businesses, and slows growth in the private sector. I strongly feel that tax-exempt organizations that run commercial businesses should pay taxes.

Another point that must be considered is that a percentage of the YMCA's income comes from government support. As you well know, government spends tax dollars while small businesses generate tax dollars.

It is very disheartening to lose a prospective member to the local YMCA because they have more locations and a wider variety of programs at a lower cost.

I would like Congress to address the issue and provide small businesses with protection from unfair competition from nonprofit. I recommend that the U.S. Treasury Department should be required to provide a public estimate of revenues lost through nonprofits' avoidance of Unrelated Business Income Tax (UBIT). Congress should also authorize the General Accounting Office (GAO) to undertake a study to determine the extent to which nonprofit health and fitness centers actually serve needy individuals and charitable classes. A similar study of non-profit hospitals showed that they often serve fewer indigent or needy cases that for-profit, taxpaying hospitals.The Small Business Committee should call on their colleagues in Congress to clarify the tax laws governing commercial activities by tax-exempt organizations.

Sincerely,

Daron Allen

Daron Allen
Executive Director

Prevention Works Wonders.
6242 Hulen Bend Boulevard Fort Worth, Texas 76132 (817) 346-6161 FAX (817) 346-9101
Mailing Address: 6211 Oakmont Boulevard, Box 393 Fort Worth, Texas 76132
Corporate Office (817) 346-6985
An affiliate of Osteopathic Health System of Texas.

Second Wind

Austin's Fitness Innovator

July 24, 1996

The Honorable Jan Meyers, Chair
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

RE: UNFAIR COMPETITION

This letter is being submitted to the House Small Business Committee for its official record.

It is my opinion that unfair competition hurts the small business community, those that are now, and increasingly in the future, fueling economic growth.

I own a health club in Austin Texas, and a YMCA is soliciting support for a facility in the area. An area whose medium household income in 1994 was $47,070. Although, the facility has not been built, I fear for loss of revenue in the future. It has been my experience in dealing with the YMCA's (that operate in such an affluent area) that their claims of opening and operating are for the benefit of needy kids (which is not needed in such an affluent area) it is a known fact, attested to by YMCA officials, that the fitness center is what generates the income.

I am asking Congress to address the issue and provide small businesses with protection from unfair competition from nonprofits. I recommend the following:

①The U.S. Treasury Department should be required to provide a public estimate of revenues lost through nonprofits' avoidance of Unrelated Business Income Tax (UBIT).

②Congress should authorize the General Accounting Office (GOA) to undertake a study to determine the extent to which nonprofit health and fitness centers actually serve needy individuals and charitable classes.

13945 Highway 183 North • Austin, Texas 78717 • (512) 219-8888 • Fax (512) 219-8889

Second Wind

Austin's Fitness Innovator

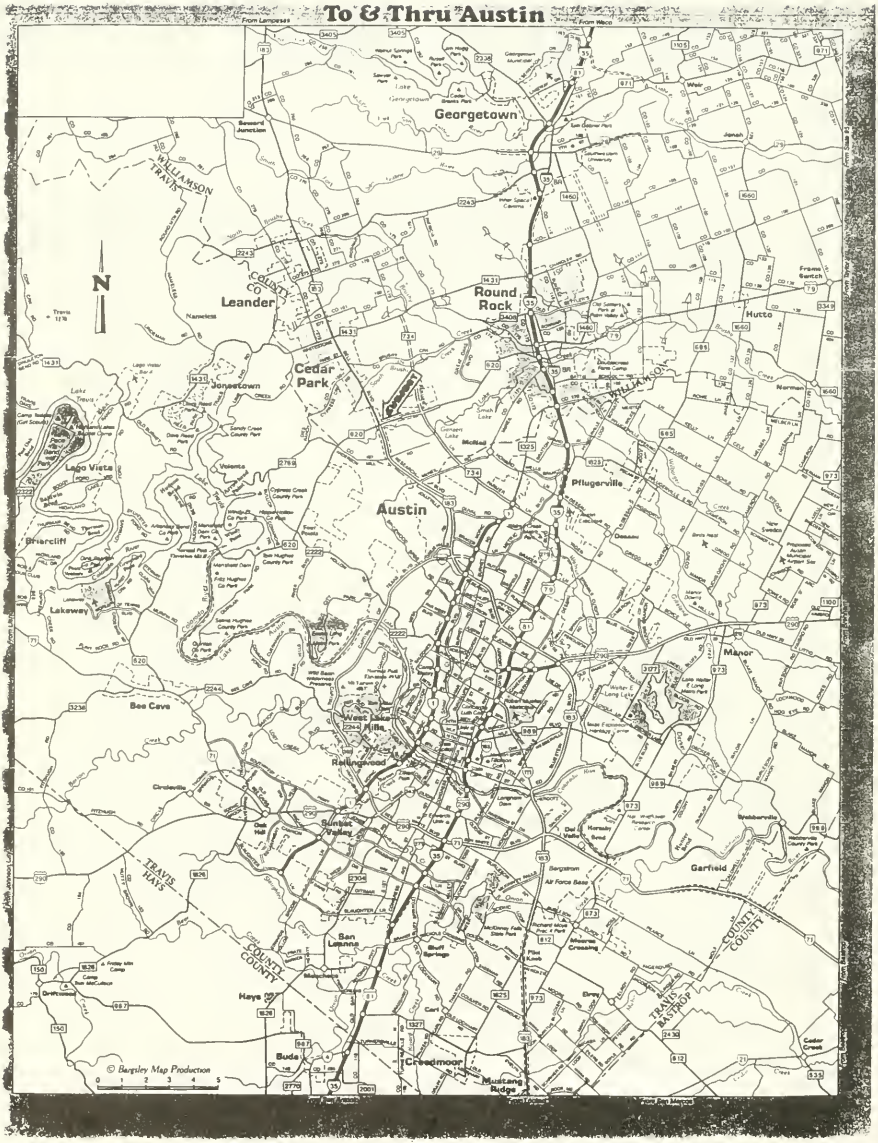
③The Small Business Committee should call on their colleagues in Congress to revise the tax laws governing commercial activities by tax-exempt organizations so that there is no confusion about their liability.

Thank you for your attention to this matter.

Your, In Good Health,

Mike Avera
President

13945 Hwy 183 North • Austin, Texas 78717 • (512) 219-8888 • Fax (512) 219-8889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Pocono Wellness & Sports Center

R.D. 7 Box 7001, Eagle Valley Mall
East Stroudsburg, PA 18301
(717) 424-2333 FAX (717) 421-8290

August 2, 1996

The Honorable Jan Meyers
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Madame Chairman:

Please submit this letter to the House Small Business Committee for the official record regarding unfair competition hearings which were held on July 16, and July 18 of this year.

As small business owners in the athletic club industry, we are writing to you regarding the hearings recently held by the House of Representatives' Committee on Small Business, concerning competition facing small businesses from the government and non-profit organizations. We face very real and substantial competition from various non-profit/community based facilities which provide similar services as our business. These organizations include YMCA's, Hospital based facilities, and State University facilities.

The greatest impact we see is the ability of these facilities to charge a great deal less for their services, because of their favorable non-profit tax status, free and reduced advertising rates in all media forms, and their ability to stage various fund raising events to raise monies. In addition, businesses who give "donations" to these facilities receive even lower cost memberships for their employees. Whether or not these "donations" are also a tax deduction for the business is a question. Obviously, as a for profit business, we cannot utilize any of these such advantages.

Because of this price difference, many individuals and businesses purchase services from non-profits. One recent additional advantage that the YMCA had acquired, due to lower cost, is an exclusive arrangement with Blue Cross/Blue Shield in Northeastern PA. This insurance group will reimburse subscribers for YMCA programs **ONLY**, unless there is no YMCA in the subscribers local area. Blue Cross/Blue Shield is the MAJOR health insurance/HMO provider in our area -- how can we compete with this? We have lost 300 members in the last year because of this, and our taxes continue to increase.

"Where People Of All Ages Enjoy A Healthy Lifestyle"

We are asking that Congress address this issue and provide small businesses with protection from unfair competition from non-profit organizations. Here are our recommendations:

Clarification of the tax laws governing commercial activities by tax-exempt organizations. Congress will act if called on by their colleagues on the Small Business Committee.

Require the U.S. Treasury Department to provide the public with an estimate of tax revenues lost through non-profit's avoidance of Unrelated Business Income Tax (UBT).

The General Accounting Office (GAO) should be authorized, by Congress, to determine to what extent non-profit health and fitness centers actually serve needy individuals and charitable classes.

Won't you please take action to protect the Small Businesses who are providing jobs, paying taxes and working hard to stay alive? Thank you for your attention.

Sincerely,

Kevin G. Boorse
President

Julie S. Boorse
Vice President

August 5, 1996

The Honorable Jan Meyers
Committe on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Madame Chairman:

I am requesting that this letter be submitted to the House Small Business Committee for its official record regarding the unfair competitiion hearings held in July.

The impact that unfair competition has on Fitness World in Durham, North Carolina can not be understated. Recently, a brand new YMCA was approved for downtown Durham. The facility will be built on land that the city and county paid $700,000 for and then donated to the YMCA. Further, the city plans to pay the YMCA $70,000 a year to provide recreation services. The interest it will generate as a result of its full-size gym, walking/running track, aerobic/dance studio, day care facilities, and two swimming pools will be tremendous. The financial support that the YMCA receives, coupled with the countless tax exemptions its "nonprofit" status allows for and its state- of-the art facitlities make it a very difficult organization to compete with.

The YMCA should focus on providing exercise and recreational programs for young adults and children. This is the principle upon which it was originally founded. The adult population has numerous options to choose from including; six commercial centers, several centers run by the City of Durham Parks & Recreation (consisting of over 60 parks), three local universities, as well as exercise facilities provided by area apartment and housing complexes. Durham, North Carolina is saturated with exactly the type of facility that the non-profit YMCA is going to be providing.

Without question we will lose potential members to nonprofit organizations such as the aforementioned YMCA, not to mention the competition we face from those nonprofit organizations already in place. At the same time, we pay all of the taxes that these facilities are exempt from.

As a small business, we are asking Congress to address this issue so as to protect us from what is clearly unfair competition. The following are some recommendations:

Fitness World / Westgate Shopping Center
3400 Westgate Drive / Durham, North Carolina 27707
(919) 490-1991

*The U.S. Treasury Department should be required to provide a public estimate of revenues lost through nonprofits' avoidance of Unrelated Business Income Tax (UBIT).

*Congress should authorize the General Accounting Office (GAO) to undertake a study to determine the extent to which nonprofit health and fitness centers actually serve needy individuals and charitable cases.

*The Small Business Committee should call on their colleagues in Congress to clarify the tax laws governing commercial activities by tax-exempt organizations.

I appreciate your attention to this matter.

Sincerely,

Mark Bradley
President
Fitness World, Inc.

STA-FIT, INC., ATHLETIC FACILITY / MANAGEMENT & CONSULTING

August 1, 1996

The Honorable Jan Meyers
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Madame Chairman:

I request this letter be submitted to the House Small Business Committee for its official record. This letter is in regards to the unfair competition hearings held in July.

The local YMCA near our facility located in downtown Spokane offers the same facilities, actually more, than we offer at a lower monthly fee. Their single person monthly fee (offered to the public) is $33 per month compared to ours at $42.95. A family fee is $48 per month compared to our fee at $52.95. The YMCA has two pools and two gymnasiums included in their monthly fee. We do not have these facilities downtown. I assure you our monthly fee is not higher than necessary to cover our operating costs.

Several personnel in our organization have made inquiries as to the monthly fee and facilities offered by the YMCA. Not once, in any of these inquiries, were they asked their income level.

It does not appear the not for profits are merely serving the underprivileged as they were initially set up to do, in this example. The YMCA is competing for the same customers and dollars as we are.

I guess that explains why they have three times as many members downtown as we do.

[illegible]
SPOKANE, WA [illegible]
(509) 448 [illegible] • FAX [illegible]

Currently, there are plans to develop another, even larger YMCA in Spokane's Valley. This will enable them to compete with the tax paying fitness centers on an even larger scale.

This is a formal request. I am asking Congress (the people's voice) to address this issue. Myself, as well as other small business's need protection from unfair competition from not for profits.

It is difficult to compete with these not for profits. They are able to offer lower rates for the same facilities due to less overhead and operating costs from the unfair breaks they receive. We can't compete!

I recommend, the U.S. Treasury provide to the public, an estimate of revenues lost through the tax breaks allowed to nonprofits thru the Unrelated Business Income Tax. These revenues, if collected, could even help balance our budget.

I would also like to see Congress authorize the General Accounting Office to study the extent to which nonprofit health and fitness centers actually serve needy individual and charitable classes.

I also request the Small Business Committee ask their colleagues in Congress to clarify the tax laws governing commercial activities by tax-exempt organizations.

I feel all of this is necessary to remedy the unfair competition in the health and fitness industry.

Sincerely,

Jeffrey G. Brannon
President

Athletic Clubs Incorporated

4020 WestChase Boulevard, Suite 425
Raleigh, North Carolina 27607
(919) 828-6961 • Fax (919) 828-7910

July 23, 1996

The Honorable Jan Meyers, Chair
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Ms. Meyers:

I am sending this letter to the House Small Business Committee for it's official record. The intent is simply to voice my opinion on the unfairness of tax-exempt competition in the health and recreation club industry.

Our company, Athletic Clubs Incorporated, has been in business for 15 years with 5 current facilities serving their respective communities in North Carolina. Competition from YMCA's and hospital-owned facilities is making it increasingly difficult for us to operate a profitable business. Our membership has declined 6% from last year which is the primary source of revenues for our facilities. In each of our markets, except one, YMCA's are our #1 competitor for health club members. In the one exception, the county non-profit hospital has just announced a 7 million dollar wellness center that will sell fitness memberships to the public located not 100 yards from our back door!

We are 100% supportive of the YMCA and YWCA original mission of serving the underprivileged and providing a safe haven for the community. However, along the way the concept has become diluted. Our local YMCA's are 45,000-80,000 square foot superclubs located in upscale communities with memberships that require a $200 enrollment fee and $50 per month. The underprivileged have become an over statement. If you look beyond the big letters on the marquee, YMCA's have become a profit-making enterprise. Now non-profit hospitals are attempting to take the same advantage. Neither of these institutions pays taxes! This means they have an immediate unfair advantage. They can add more staff than we can afford. They can pay more that we can afford. They can undercut our membership rates and expand their facilities and services more rapidly than we can. In our markets, these are all happening.

Left unbridled, it won't take many years before these types of facilities will put our clubs out of business. We don't mind competing - but we're asking congress for a level playing field.

PEOPLE SERVICE QUALITY

YMCA's and other non-profits who are competing for the same customer as a tax-paying business should have to pay taxes and be just as fiscally responsible.

Our recommendations are:

- The U.S. Treasury Department should be required to provide a public estimate of revenues lost through non-profit's avoidance of Unrelated Business Income Tax.

- Congress should authorize the General Accounting Office to undertake a study to determine the extent to which non-profit health and fitness centers actually serve needy individuals and charitable classes.

- The Small Business Committee should call on their colleagues in Congress to revise the tax laws governing commercial activities by tax-exempt organizations so that there is no confusion about their tax liability.

The future of our industry is at stake! Thank you for your assistance in this matter.

Yours truly,

Dan Campbell
Director of Marketing
and Sales

DFC/trk

cc: John Kane
Ric Zimmerman
Helen Durkin

UNIVERSAL
RACQUET & FITNESS
CENTER
2323 Oregon Pike • Lancaster, PA 17601
(717) 569-5396

August 1, 1996

The Honorable Jan Meyers
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, D.C. 20515

Dear Madame Chairman:

I am writing to address the issue of unfair competition small businesses face from the government and nonprofit organizations. I request that this letter be submitted to the House Small Business Committee for its official record regarding the unfair competition hearing held on July 16 and 18, 1996.

As you know, the problem of unfair competitions begins with "charitable" institutions taking advantage of their tax exempt status to aggressively invade the health and fitness market. These tax exempt clubs can operate at two-thirds the cost of our tax-paying club by avoiding real estate, sales and income tax, and by their ability to accept "tax deductible" donations for the construction of these facilities.

Being a small business in Lancaster County, Pennsylvania our club feels the effects of more than a few non-profit organizations. Within a 4 mile radius of Universal Racquet and Fitness Center we directly compete with a YMCA, a YWCA, a Community Center and a 1/4 mile away is a Jewish Community Center. In the fitness community we compete head to head with the above organizations offering the same services. Our competing services including tennis & racquetball, aerobics, cardiovascular and weight resistance training, fitness screenings as well as daycare and children's programs for all ages.. Our fear lies in the fact that when offering similar or better services to the community we can not offer these services at the same rate as the other organizations. Their rates are significantly lower due to the fact that our tax dollar is supporting all of the other organizations. While they should to be offering programs to needy individuals and charitable cases they are instead offering discounts on their programs *and advertising these discounts in newspapers and on the radio.* What happened to the real reason the "Y" was developed in the first place.

We are asking you to continue addressing this issue and provide small businesses with protection from unfair competition from non-profit organizations. The following issues should be addressed but not limited to the following:

- We strongly encourage you to have the U.S. Treasury Department be *required* to provide a public estimate of revenues lost through nonprofit's avoidance of Unrelated Business Income Tax.
- Congress should authorize the General Accounting Office to undertake a study to determine the extent to which nonprofit health and fitness centers *actually serve* needy individuals and charitable classes.
- The Small Business Committee should call on their colleagues in Congress to *clarify the tax laws* governing commercial activities by tax-exempt organization.

Please take measures to ensure that those of us who pay our taxes are not penalized in the marketplace for doing so. We urge you and your colleagues in Congress to follow through on previous efforts to reform the Unrelated Business Income Tax.

Sincerely,

Richard A. Casselbury
Owner

July 17, 1996

Chairman Meyers and Members of the Committee
House Small Business Committee
2361 Rayburn House Office Building
Washington, DC 20515-6315

Chairman Meyers and Members of the Committee:

I am submitting this position paper to the House Small Business committee for its official record. I am the owner of a single location health club who has been damaged by competition from tax-exempt COMMERCIAL NON-PROFITS.

You have probably never heard of a COMMERCIAL NON-PROFIT, but they are everywhere and they are putting honest, hard working small business people out of business. They are traditional non-profits who may refer to themselves as "charities" but engage in blatantly commercial enterprises for profit. In my business this includes YMCA's and hospitals opening tax exempt, tax payer supported health clubs. Commercial non-profits have become major competitors for most small businesses.

I am enclosing a copy of formal testimony I submitted in Pennsylvania earlier this year. We were able to amend PA Senate Bill #355 to include Section #19, which prohibits non-profits from engaging in funding, capitalizing, or otherwise guaranteeing any commercial business.

The problem of non-profit competition must be addresses at the federal level. As depicted in the enclosed economic analysis, the growth of non-profits causes a massive loss of federal revenue, narrowing the tax base, and causing higher taxation to the general public. I implore you to take action to save small business from its tax-exempt competitors.

Yours truly,

David J. Cohan, Pres.
SPORTS CLUB

Woodlyn Square Shopping Center
Woodlyn, PA 19094
(215) 833-2000

TESTIMONY BEFORE THE PENNSYLVANIA HOUSE FINANCE COMMITTEE
4/11/96

DAVID J. COHAN
18 Adele Drive
Richboro, PA 18954

Good morning. My name is David Cohan and I am the owner of the Sports Club, a multi-purpose health club located in Woodlyn, PA. I want to thank the committee for this opportunity to testify today.

Even though I am here to represent the small business community, I feel compelled to address the detrimental economic effects of commercial non-profits. My testimony will focus on the devastating effects which non-profit businesses have on the small business community, as well as on government tax collections, taxpayers in general, and consequently the economic well-being of the entire state.

Small business has provided more than 100% of the job growth during the last decade. As big businesses continually downsize, it is small business that is expanding and hiring displaced workers. During the last decade, a new kind of business has emerged to challenge small businesses in every city and town in America. It is not the downsizing ***big*** business, but a new business entity which I describe as a commercial non-profit.

A commercial non-profit is a traditional non-profit that engages in a commercial activity or business to expand its revenue base, size and influence. Commercial non-profits are the fastest growing businesses in the United States. According to the Wall Street Journal, non-profits controlled 10.4% of the gross domestic product in 1990 and were expanding rapidly.

Something is dreadfully wrong here. Gross domestic product is supposed to be produced by taxpaying businesses which enhance the productive capacity and economic well-being of the country. This rapid expansion of commercial non-profits not only injures small businesses and their employees, but dramatically lowers tax revenues at every level of government, thereby forcing higher taxes on the remaining for-profit businesses and their employees.

It should come as no surprise that local taxing authorities are attacking the tax-exempt status of commercial non-profits or that the non-profit community has

introduced this legislation to protect their interests. The scope of this bill deals with local and state tax issues. However, as the accompanying chart shows, non-profit status has far-reaching economic effects. The growth of commercial non-profits affects for-profit business decisions and government tax revenues on many levels. The introduction of tax policies which favor commercial non-profits shifts the tax burden to remaining for-profit businesses and the general public. The Pennsylvania economy has been suffering because of its noncompetitive position in relation to neighboring states. In fact, the city of Philadelphia has the highest combined tax burden of any city in the United States.

On January 25, 1996 Mr. David B. Glancey, Chair of the Philadelphia Board of Revision of Taxes testified before this committee. During his testimony he stated:

"The City of Philadelphia strongly opposes Senate Bill 355. Its timing could not be worse: this legislation could greatly expand the number of tax-exempt organizations at the precise moment when the Commonwealth and localities throughout Pennsylvania face draconian cuts in federal funding for essential programs. . . .

"Senate Bill 355 is fundamentally unfair to taxpayers who will be called upon to pick up the tab for the services provided to an ever-expanding list of nonprofits."

". . .far too many institutions that receive the benefit of tax-exempt status are in many respects indistinguishable from taxable businesses."

"Senate Bill 355 throws a blanket of protection around virtually all current and would-be nonprofits in Pennsylvania, including well-funded enterprises that in some instances are hard to distinguish from taxable businesses. While purporting to rewrite the HUP criteria, Senate Bill 355 instead appears to drastically water down the test, giving a virtual free pass for any would-be public charity."

"Remember: someone must pick up the tab for the governmental services provided to every tax-exempt organization in the Commonwealth. To increase the number of tax-exempt organizations is to increase the burden on every other tax-paying citizen and business."

In virtually all respects, *nonprofits are no different from tax-paying organizations in the demands they place on essential services supported by local tax dollars*. This is no small problem: in Philadelphia alone, nonprofit institutions own over 25 percent of the City's total assessable properties. Since these non-

profits are exempt from paying property taxes, the burden on those remaining to pay these taxes is 33% higher. I presented the accompanying chart at the June 1995 White House Conference on Small Business. The chart depicts the tremendous competitive advantages enjoyed by commercial non-profit businesses. In fact, on a $5 million project which generates a modest 6% return of $300,000 in pre-tax income, a commercial non-profit has a $918,103 annual advantage over a taxpaying business. Non-profit competition has been a major issue for the small business community ranking #3 and #14 respectively in the last two White House Conferences.

As depicted in the accompanying chart, commercial non-profits present an insurmountable problem for small businesses. However, they also represent substantial tax losses at all levels of government and tax shifting to hardworking people of the Commonwealth.

While local governments have recognized the drain on their revenue base caused by exempting non-profits, most of the tax loss and subsequent shifting of the tax burden is due to other issues. For the project on the chart, direct annual tax losses total $229,950 : $100,000 in Property Tax revenue, $29,700 in State Income Tax, and $100,250 in Federal Income Taxes. Local taxing authorities generally are aware of the $100,000 Property Tax Issue. They never consider the indirect reduction of local tax revenues caused by the loss of State and Federal Tax Revenues and the resulting reduction in funds available for revenue sharing.

Furthermore, capital campaigns by non-profits to fund land, buildings and equipment cause further substantial losses of income tax revenues as these "charitable donations" are used as itemized deductions to reduce taxable income. The annual tax loss from the capital campaign on this project is conservatively estimated at $226,000. This is 1/3 of the total deductions claimed of $678,153 : $60,856 for land, $486,842 for building, and $130,455 for furniture and equipment.

So far, our analysis shows a direct annual tax loss of $229,950 and an annual indirect tax loss of $226,000. But there is more. Non-profits do not pay sales taxes, capital stock taxes, mercantile taxes, business taxes or personal property taxes. The clients who purchase valuable goods or services from non-profits often deduct the fee from their income tax as a "charitable donation". It is not a donation; it is payment for value received. Haven't we all done this? I have no way of estimating how much additional tax revenue is lost at every level of government due to this practice.

Our tax base is being eroded. The burden is being silently and insidiously shifted to the hardworking people who remain in the private sector. Non-profits should be commended for their valuable contributions to society. However, commercial non-profits that compete with small business are damaging the economy of the country, eroding tax revenues, and shifting the tax burden to hardworking employees. What is the justification for exempting blatantly commercial businesses such as the National Football and National Basketball Leagues and shifting their share of taxes to the rest of us?

If you act to expand the tax-exempt sector, you will narrow the tax base thereby increasing taxes. You must act to *broaden* the tax base and lower taxes by including *all* who should pay. This can be accomplished by strictly defining those who legitimately qualify for tax-exempt status.

Both sides of the political aisle should be able to draft a compromise bill that achieves everyone's objectives. The Governor has recognized the non-competitive position of the Commonwealth in competing for business. He has pushed to enact business tax reforms aimed at improving this situation. Democratic legislators have seen the continual erosion of the tax base in the big cities of the Commonwealth and the limitation of revenue sharing. Broadening the definition of a tax-exempt would punish our cities, and accelerate the decline of their tax bases. Taxes will continue to increase, and businesses will flee.

It's obvious to see how I am threatened by a non-profit that decides to open a competing business in my market. A YMCA opened approximately two miles east of my health club and a non-profit hospital is funding a massive health club and rehabilitation center two miles to the north. The chart clearly shows that I face a nearly insurmountable competitive disadvantage.

I call on you to protect the people of the Commonwealth by passing SB#355 with Section #19 strengthened. The eligibility for non-profit status must be tightened and standardized throughout the state. Ideally, commercial non-profits should be privatized or otherwise put on the tax rolls. Chief executives of most large nonprofits make more money than the President of the United States. A salary cap is appropriate and should be enacted. Experience has shown that commercial non-profits treat small businesses with disdain and will not cooperate or share information. Therefore, the burden of proof that a non-profit is not damaging a small business must be with the non-profit.

I thank the committee for this opportunity to testify and welcome your questions about my presentation or how my small business has been directly affected.

A TAX-EXEMPT COMPETITOR CAN ENJOY AN ANNUAL COST ADVANTAGE OF ALMOST $1 MILLION ON A $5 MILLION PROJECT*

ITEM	ASSUMPTIONS	ANNUAL COST TO PUBLIC OR NON-PROFIT SECTOR	ANNUAL COST TO PRIVATE SECTOR
Property Taxes	Assumes $4 million property value @ 50% taxation rate of $5 per $100	0	$100,000
State Income Taxes	State Tax Rate of 9.9% on profit of $300,000	0	$ 29,700
Federal Income Taxes	Federal Tax on $300,000 of profit	0	$100,250
Annual Land Carrying Cost	$500,000 borrowed 15 yrs. @ 9%	0	$ 60,856
Annual Building Mortgage	$4 Million borrowed 15 yrs. @ 9%	0	$486,842
Furnishings & Equipment	$500,000 borrowed 5 yrs. @ 11%	0	$130,455
Postage	Non-profit or public sector entitled to 33% discount	$20,000	$ 30,000
TOTAL ANNUAL COST		$20,000	$938,103

ANNUAL COST ADVANTAGE TO THE COMMERCIAL NON-PROFIT $918,103

*Does not include sales, capital stock, mercantile business or personal property taxes assessed on private sector, but not levied on commercial non-profits.

DEDHAM HEALTH & ATHLETIC COMPLEX
200 PROVIDENCE HIGHWAY
DEDHAM, MA 02026

August 5, 1996

The Honorable Jan Meyers
Committee of Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Madame Chairman:

We request that this letter be submitted to the House Small Business Committee for its official record regarding the unfair competition hearings held in July.

Unfair competition has a tremendous impact on our club. For instance, we are six(6) air miles away from the JCC in Newton who has $2,300,000 in annual sales of Adult Club Memberships. We have lost at least 480 members to them, at an average of $888 annually, for a total of $426,240 (A) per year. The Newton JCC is a plush facility with an Executive Fitness Center, track, basketball, aerobics, indoor pool, etc.

In the summer of 1996, the Newton JCC opened an outdoor country club type pool. We lost 37 family memberships to them, and were told by 59 families that they would have joined our outdoor facility had it not been for the Newton JCC. This is a total of 96 family memberships that we lost to the Newton JCC, at an average of $600 a piece, for a total of $57,600 (B).

The Newton JCC charges approximately the same price as our club for the indoor adult fitness membership. The price of their outdoor facility is $500 to their building fund and $500 for membership, for a total of $1000. The Newton JCC took in a total of $425,000 for their outdoor club this year (425 families x $1000).

Recap of revenue lost, it's income, and tax effect;

(A) Indoor Facility (DHAC)

Lost Revenue	$426,240

(B) Outdoor Facility (DHAC)

Lost Revenue		$57,600	
Total	=	$483,840	
* Less costs	-	$48,384	10%
Lost to Newton, MA JCC		**$435,456**	
Lost Federal Govt. Taxes		**$130,637**	30%
Lost cash flow to DHAC		$304,819	

* Since we have no cost of goods sold, 90% goes to the bottom line at this point in our profit structure.

Even though it is against tax law, we believe from interviews that 90% of the dollars collected by the JCC's, YMCA's, colleges and universities are taken as tax deductions on personal income tax returns. So not only did the federal government loose the $130,637 from Dedham Health & Athletic Complex, but they also lost an additional $114,900 in illegal tax deductions.

Example		$425,000 JCC collections for outdoor pool
	-	$42,500 10% not taken as tax deduction
		$382,500. 90% illegal tax deductions
		x 30% = $114,750. Estimate

Impact of just one JCC on our club;

A) Loss of $435,456 net profit for DHAC before taxes

B) Loss of $245,387 to federal government for taxes
$130,637 from DHAC
$114,750 from illegal tax deductions

This loss of revenue is an example of how one(1) non-profit organization affects one(1) profit organization. If you look further and see how other JCC's, YMCA's, colleges and universities affect the whole industry, you will see that it is astronomical.

We ask that Congress address this issue and provide small businesses with protection from unfair competition from nonprofits. These are our recommendations:

- The U.S. Treasury Department should be required to provide a public estimate of revenues lost through nonprofits' avoidance of Unrelated Business Income Tax(UBIT).

- Congress should authorize the General Accounting Office (GAO) to undertake a study to determine the extent to which nonprofit health and fitness centers actually serve

needy individuals and charitable classes. (A similar study of non-profit hospitals showed that they often serve fewer indigent of needy cases that for-profit, taxpaying hospitals.)

- The Small Business Committee should call on their colleagues in congress to clarify the tax laws governing commercial activities by tax-exempt organizations.

Thank you for your cooperation in this matter.

Sincerely,

Lloyd Gainsboro
Dedham Health & Athletic Complex

NEWPORT ATHLETIC CLUB

est. 1980

August 6, 1996

The Honorable Jan Meyers
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Bldg.
Washington, DC 20515

Dear Representative Meyers,

Please submit this letter to the House Small Business Committee for its official record regarding unfair competition.

Please change the laws dealing with the non-profit industry which allow non-profit YMCA's to compete with for profit fitness facilities.

As a small business owner (health club) I have felt the impact of the YMCA's marketing campaigning which is targeted at the upscale, upper income population of my community. Though deep discounts , corporate discounts and other corporate incentives the YMCA has managed to undercut my ability to compete for the same market segment.

The charter of the YMCA is to provide services to the community which are not otherwise available. Located in an upscale industrial park in the affluent suburbs which are not accessible by public transportation, my local YMCA's is unable and does not service the most needy of our community. The YMCA therefore has excess capacity which they market to the well paid employees of the industrial park and the contractors serving the park.

My lost review to the YMCA's non charitable operations is estimated to be $120,000 each year. The loss to the community is close to $400,000 each year. The more critical loss to the community however, is the annual gift to the YMCA of $94,000 from the United Way which would otherwise be available to the truly needy

66 Valley Road • Middletown, RI 02842 • (401) 846-7723 • Fax: (401) 846-7729

Please put a stop to this blatant miss use of a charitable status by:

A) requiring all non-profits to identify and pay taxes on their unrelated business income.

B) authorizing the GAO to determine the true extent of the non-profit service to local communities.

C) having the Small Business Committee call upon their colleagues in Congress to clarify the tax laws governing commercial activities by tax-exempt organizations.

Very truly yours,

Roger D. Grady

OAK BROOK RACQUET & FITNESS CLUB

TENNIS — FITNESS — SWIM — RACQUETBALL

650 WESTMONT DRIVE
WESTMONT, ILLINOIS 60559
PHONE: (630) 654-2442

August 2, 1996

The Honorable Jan Meyers
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Madame Chairman.

Please submit this letter to the House Small Business Committee for its official record regarding the unfair competition hearings held in July

I am a tennis/fitness/swim club general manager at a 23-year old facility in the western suburbs of Chicago within Dupage County. This is one of the wealthiest communities in the country. Yet our business is becoming increasingly surrounded by tax-exempt, unfair competition, much of which is positioned to be worthy of charity due to serving the indigent! This makes no sense!

Two very elegant park district facilities are in the town next to us The second multi-million dollar facility was built even though the residents, through a referendum, voted down the idea by a 3-1 majority a few years ago It seems Park Districts can find a way to build what they want to build. These two facilities negatively impact our bottom line Since they pay no property taxes and we pay very heavy taxes we cannot operate on the same "playing field " Yet, our members and potential members expect us to meet their prices We can't do that and still operate at a profit. We lose many people each season to this problem

One block away from my business stands another Park District Health and Fitness Club The Park District purchased a privately-owned, tax paying club and took it off the tax rolls. The government put over one million dollars into the building and competes against us by charging less than we can charge. We have looked at their Profit & Loss statements and they run at a loss They used government dollars to buy a busines that used to generate taxes for the government and now run it at a loss Meanwhile, our business has to struggle against this I consider this unfair competition

The YMCA has a large presence in our marketing area (wealthy Dupage County) and is actively courting Hinsdale, Illinois' Park District to go in partnership in building an enormous fitness/swim facility. The YMCA derives much money from the United Fund, pays no taxes, and is purported to be in existence to use a reasonable amount of their services to serve the indigent Check out where they've built their facilities within the past number of years and I'm sure you'll find they're located in affluent suburbs of major cities

Finally, attached is a copy of an article from our local newspaper THE DOINGS that describes what is happening in another adjoining town where many of our members live. It never stops

I love competing with the for-profit clubs in my area We all pay taxes and have to make a net profit to stay in business. This brings out the best in us to create and provide the best product we can for our customers. I cannot compete against unfair competition

Please, please protect our clubs from unfair competition from nonprofits I suggest.
-The U.S. Treasury Department should be required to provide a public estimate of revenues lost through nonprofits' avoidance of Unrelated Business Income Tax.
-Congress should authorize the General Accounting Office to undertake a study to determine the extent to which nonprofit health and fitness centers actually serve needy individuals and charitable classes.
-The Small Business Committee should call on their colleagues in Congress to clarify the tax laws governing commercial activities by tax-exempt organizations

I sincerely hope your committee will think of the small club, taxpaying citizens out in the "trenches" as you consider this issue.

Thank you

Lucia Haas
General Manager
Oak Brook Racquet & Fitness Club
650 Westmont Drive
Westmont, Illinois 60559

FITNESS CENTRE
(219) 865-6969
Fax (219) 865-6683

BLADE 'N SKATE
(219) 865-1662

OMNI Sports and Fitness Centre

TIME OUT SPORTS BAR
(219) 865-2822

MVPIZZA
(219) 865-2822

August 5, 1996

The Honorable Jan Meyers
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, D.C. 20515

Dear Madame Chairman:

I respectfully request that this correspondence be submitted to the House Small Business Committee for its official record regarding the unfair competition hearings held in July.

The enclosed reprint of a recent industry publication centers on the continuing struggle that confronts private sector businesses across the country.

The health and fitness industry maintains that competition is necessary, but on a level playing surface.

The not-for-profit sector has taken unfair advantage of their status and has become a direct competitor with health and fitness facilities.

A prime example being the YMCA expansions of facilities and programming across the country. The basic mission of the YMCA is good but they have lost their primary focus and have positioned themselves as direct competition.

The nation YMCA's generated $1.2 billion last year. If it were a for-profit business, it would have ranked #295 on Fortune Magazines Fortune 500.

All that income and not a dollar paid in taxes. Is that equitable? Is that fair competition? We think not.

Enclosed is a copy of correspondence directed to U.S. News and World Report in regard to their cover story of October 2, 1995.

The result of a local YMCA entering our demographic area and overlapping services already provided has meant a decrease in revenue on certain programs of 10% to 20%.

Open 24 Hours/7 Days A Week
221 SOUTH ROUTE 41, SCHERERVILLE, INDIANA 46375

The Honorable Jan Meyers
Washington, D.C.

We have fought long and hard to stop further advances by the YMCA that will impact our income by decreasing it by 40%. We will not be silent while not-for-profit businesses "pick the pockets" of the american taxpayers and private sector business.

Private sector business needs your help to establish sweeping changes that will provide protection from unfair competition.

The U.S. Treasury Department should be required to provide a public estimate of revenues lost through non-profit's avoidance of Unrelated Business Income Tax (UBIT).

Congress should authorize the General Accounting Office (GAO) to underteke a study to determine the extent to which non-profit health and fitness centers actually serve needy individuals and cheritable classes.

The Small Business Committee should call on their colleagues in Congress to clarify the tax laws governing commercial activities by tex exempt organizations.

Your efforts to establish fairness and equality in the resolution of this problem are greatly appreciated.

Sincerely,

John M. Kohan

John M. Kohan
Community & Corporate Relations

JMK/sw
encl.
cc: File

IHRSA

International
Health, Racquet &
Sportsclub Association

Position Paper

Fair Competition in the '90s

A general principle and a growing problem

IHRSA believes that *the growth of private enterprise is essential to the health, welfare and prosperity of any nation.* Government should foster economic opportunities for private industry. Government should protect private industry from unfair competition by government agencies and tax-exempt organizations.

Unfortunately, government agencies too often engage in direct competition with private business. They also allow tax-exempt organizations to enjoy unfair tax and other advantages in competing against for profit companies in the commercial marketplace.

Unfair competition is bad public policy

Competition between the private sector and governmental and tax-exempt organizations is counterproductive. This is especially true in the area of health and fitness. Scarce resources are wasted when governments and tax-exempt organizations duplicate goods and services already offered by the private sector.

Rather than compete with each other, government, tax-exempt organizations and the private sector should work together. The goal should be to educate all Americans on the dangers of sedentary lifestyles and to encourage them to participate in regular exercise. When government entities and tax-exempt organizations like universities, hospitals, YMCAs, and JCCs operate subsidized health clubs, they inflict damage not only on the free enterprise system, but on themselves. When they compete directly with the private sector, they impede cooperative educational ventures, joint programming, and small business support of the United Way and the YMCA.

Duplication of services leads to waste

In a time when the needs of society are greater than the resources available to address those needs, our society should make sure that available funds go were they are most needed and can do the most good. The Washington D.C. United Way and other United Ways have recently recognized this need, and have changed the way they allocate money. Under the new system, tax-exempt organizations must compete for their grants each year. They must demonstrate that their particular service is more pressing than others. We believe that this new allocation system is appropriate. We don't believe that a health and fitness facility for the affluent will do well in this kind of competition.

Here are a few counter-productive examples of the duplication of services between the tax-paying, tax-exempt and public sector.

- Merritt Athletic Clubs operates health clubs in Downtown Baltimore, Annapolis, and Salisbury, Maryland. Despite protests from

the business community, a YMCA built a new $2,000,000 facility in Salisbury, Maryland. The existing Merritt Athletic Club in Salisbury lost 33% of its members to the YMCA.

- East Side Athletic Club in Milwaukie, Oregon suffered a 28.4% loss in revenue after the local park district's 45,000 sq. ft. aquatic complex opened its doors in June 1994.
- In Saco, Maine, New England Health and Racquet saw its sales fall 50% when the $2.6 million Northern York County Family Y opened within three miles. (The Y did not prosper from this wasteful duplication of services. In December 1993, the local newspaper, *The Journal Tribune* reported major financial troubles at the Northern York County Family Y. In February 1995, local banks announced that they would forgive $800,000 of the YMCA's mortgage. The banks offered no such deal to New England Health & Racquet.)
- In January 1994, the Lawrence Livermore Laboratory, a federal facility in Livermore California, announced plans to build a $1 million dollar fitness club for employees, despite the fact that the lab recently laid off employees due to a 14% budget cut. Due to public opposition led by fifteen area health, fitness and tennis clubs, lab officials decided that a separate government run facility was not necessary.
- The Jewish Community Center in Albuquerque, New Mexico announced plans to build a tax-exempt health club facility in the community's most affluent area. The proposed location for the JCC facility is miles away from any low income areas that need recreational facilities. Instead of building a facility in the needy areas of the community, the JCC wanted to build in an area with a median income exceeding $46,000 per year. It now appears that the IRS is withholding tax-exempt status from the proposed facility.

Governments and tax-exempt organizations should serve those in need and not operate businesses.

Government agencies and tax-exempt organizations like the YMCA, should be required to focus their primary energies and resources on needy individuals and families. Charities should fulfill the true and moral definition of charity. This means that the YMCA and other tax-exempt health clubs should stop building multi-million dollar facilities in middle and upper income areas.

A 1994 court case in South Dakota demonstrates how little charity can actually take place at tax-exempt health clubs. In that case, the Supreme Court of South Dakota ruled that a $6-million hospital-owned, tax-exempt health club was not entitled to the tax-exemption it claimed. The court found that the hospital subsidized only 0.5% of the club's 2600 memberships in some way.

If a health club is exempt from taxes, it should place much more emphasis and resources on serving disadvantaged populations to justify its exemption. The Boys and Girls Clubs have done it. They have not strayed from their original mission. Other tax-exempt organizations should also be required to stick to their missions.

The for-profit club, in essence, pays for the right to be in a community by paying taxes. The tax-exempt organization pays for the right by the service they provide to the community that would otherwise be unavailable. Without the tax-exempt organization the charitable needs of the community may go wanting. Without the taxes paid by business, the community could not function.

Fair competition principles

IHRSA believes government entities and tax-exempt organizations should be required to operate within the framework of the following fair competition principals.

1. In general, tax-exempt organizations and government entities should not compete with taxpaying businesses by providing services and facilities to markets that are being served by the private sector.

2. The "commerciality doctrine," applied in some court cases, should be used to determine the programs and activities of tax-exempt organizations. If the programs are commercial in nature they should not be entitled to tax-exempt status. Courts have used the following tests to find commerciality:
   1. sold goods and services to the public;
   2. were in direct competition with for-profit businesses;
   3. based prices on pricing formulas commonly used by for profit business;
   4. used promotional materials and "commercial catch phrases" were used to promote sales;
   5. advertised its services;
   6. hours of operation were the same as for-profit businesses;
   7. used paid staff, not volunteers.

   See *Living Faith, Inc.* V. Commissioner, 91-2 U.S.T.C (7th Cir., 1991.)

3. When considering construction of health club facilities, tax-exempt organizations and government should provide notice to all tax paying health clubs that potentially might be affected. This notification should include the location, nature, market to be served, and anticipated cost of the project.

4. Before seeking approval for the use of tax-exempt or public funds to construct health clubs, tax-exempt organizations and government agencies should commission an objective study. This should detail the economic impact on existing businesses located within 15 miles of the proposed project.

5. Prior to planning construction of new health club facilities and using tax-exempt funding, nonprofit organizations and government agencies should seek alternative ways of accomplishing the priority objectives in the private sector.

6. Tax-exempt facilities should be required to demonstrate that both the location and pricing of that facility's services will ensure that a substantial number of the users of the tax-exempt health club are disadvantaged and represent a charitable class.

7. To insure that the tax-exempt facility is available to the entire community, tax-exempt health clubs should publish and publicize a daily usage fee for the facility.

The bottom line advantages of tax supported and tax-exempt health clubs

Government owned or tax-exempt health clubs benefit from enormous financial advantages. While enjoying these advantages, they operate outside the framework of fair competition principles when they offer the same services to the same market as for-profit clubs. The financial advantages — outlined in the chart below — should be used to serve the community, not enter markets already served by the private sector.

The tax-exempt or government sector can enjoy as much as a $537,000 annual operating cost advantage over the private sector on a $3 million athletic club project*

	Annual cost to public or tax-exempt sector	Annual cost to private sector
Annual Land Carrying Costs (assuming a land value of $100,000 per acre and a 15-year loan on $500,000 at 9% interest)	0	$60,856
Annual Building Mortgage (assuming a $2-million, 15-year loan at 9% interest)	0	$243,424
Furnishings and Equipment ($300,000 borrowed for five years at 11%)	0	$78,273
Postage (tax-exempt or public sector entitled to a 33% discount)	$13,320	$20,000
Real Estate Taxes (assuming a property value of $3,000,000 at 50% taxation rate of $4 per $100)	0	$60,000
Personal Property Taxes		
State Income Taxes (state tax rate of 7% on profit of $200,000)	0	$14,000
Federal Income Taxes (federal rate of 22.25% on first $100,00 and 39% on next $100,000)	0	$61,250
Total Annual Costs	$13,320	$537,803
Annual cost advantage to public/tax-exempt sector		**$537,000**

*Prepared by Roger Ralph, President, Bel Air Athletic Club and Chairman, Harford County Coalition for Fair Competition. Assumes as a $3,000,000 facility on 5 acres. In this example, the private sector would have to pass more than $537,000 in annual costs on to the customer simply to cover property taxes, income taxes and club service. For a health club with 1,800 members, each would thus pay $538, or $29.88 extra each month. Since the YMCA or other tax-exempt or government agencies don't bear these costs, their pricing can be below market.

A private/public partnership expands community resources

Rather than wasting money on duplicate services, communities and clubs can work together and expand the reach of a community's resources. When the public and private sector cooperate, everyone wins. The following are just a few examples to illustrate how this kind of cooperation expands resources, and benefits the community — while preserving private enterprise.

- Farmington Farms Racquet Club in Farmington, Connecticut has a cooperative arrangement with the local park and recreation district. The club provides tennis pros for the park and rec district programs with the district paying $20 an hour for the pro's time. The arrangement has worked out so well that club management is negotiating a similar deal to take over the district's swimming program.
- Hampshire Hills Sports and Fitness Clubs in New Hampshire works with the local hospital to meet the needs of his community without duplicating services. This club runs all the wellness educational program for the hospital.
- Healthsport in Arcata, California came up with a winning combination for the club and the community. The company built a club on local park and recreation land. The community has the benefit of a multi-purpose health club without spending the millions of dollars other communities have to in order to get comparable facilities.
- The Bel Air Athletic Club in Harford County, Maryland and other tax-paying clubs in the county are working with the local volunteer Harford County YMCA Board of Managers to identify specific YMCA projects. These projects meet priority human needs, do not represent unfair competition, and can be financially assisted by tax paying clubs and other small businesses.

IHRSA is addressing the issue of fair competition by taking the following action:

1. It cooperates with the government and tax-exempt organizations to increase the number of Americans engaged in regular exercise.
2. It provides materials about the benefits and importance of adherence to fair competition principles. These materials are available to help educate the general public, elected officials, board members of tax-exempt organizations, business owners and their employees .
3. It educates its member clubs to take preventive measures to stop unfair competition in their communities before it starts. It also counsels them on defensive measures when they have no other choice.
4. It works to actively stop the waste in resources that occur when tax-exempt and government facilities duplicate services provided by the private sector.
5. It works with Congress and state legislators to preserve economic opportunities for private industries.
6. It encourages all businesses to support, through volunteer and financial assistance, Boys and Girls Clubs, YMCA's, and other recreational service providers when they undertake programs that serve individuals and families that cannot be served via the marketplace.

For more information about this position paper,"Fair Competition in the '90s", please call IHRSA Government Relations at 1-800-228-4772.

FAIR GAME

Special Fair Competition Issue

Volume Five; Number 6 July/August 1995

The IHRSA Newsletter Of Fair Competition & Legislative Issues

TAKING ON THE Y: ONE MAN'S STORY

STEVE CLUTE

(Fargo, North Dakota) In 1989 the Fargo-Moorhead YMCA took over a failing commercial health club. A spokesman for the YMCA told *The Forum*, the local paper, "the lease agreement will allow the YMCA to continue serving adults. The YMCA will operate as a non-profit facility even though its primary patrons will still be adult members of a former private health club."

The YMCA did operate the facility as an adult fitness center. However, in large part the Y refused to honor the outstanding memberships of the previous operator. The Y would not even provide former club members with a way to contact the previous owners of the facility. In the words of one disgruntled member, the YMCA left her with "nowhere to turn."

"Rather than raising $80,000 to fund the needed day care, the Y's chose to initiate a public fund raising campaign for a $4.5 million fitness facility that will compete directly with taxpaying clubs."

For IHRSA member Steve Clute, majority owner and manager of the All American Athletic Clubs located in Fargo, North Dakota and nearby Moorhead, Minnesota, this incident marked the beginning of the public's awareness that their YMCA wasn't a charity, but rather, a business.

After this incident, Clute wrote several articles that *The Forum* would eventually publish. Clute said he did so in order to inform community members of the tax consequences whenever a nonprofit health club, such as the YMCA, takes over a commercial taxpay-

TAKING ON THE Y, continued on page 2

NEW MEXICO CLUBS COUNTER THE JCC

(Albuquerque, New Mexico) The Jewish Federation of Greater Albuquerque wants to build a new $7 million Jewish Community/Fitness Center in one of Albuquerque's most affluent communities. There's only one problem: The JCC says it won't pay taxes. Local club operators think it should.

At the heart of the battle is Scott Garrett, who operates four IHRSA clubs in Albuquerque. Garrett is leading a coalition of New Mexico club operators who oppose the tax-exempt JCC's aggressive efforts to build a new facility and attract Albuquerque's fitness conscious consumers.

The coalition, called the New Mexico Association of Tax-Paying Recreational Facilities, has caught the attention of the local media. They in turn have put pressure on the Jewish Federation of Greater Albuquerque to justify the new fitness center. The Albuquerque Journal ran a page-one story about the health club owners concerns. While JCC officials state publicly that their purpose is to build a Jewish cultural center, not a health club, the physical plans for the facility seem to indicate otherwise. The proposed center will dedicate over 75% of its 46,000 square feet to pools, tennis courts, racquetball courts, gyms, weight rooms, aerobics area and locker rooms.

Garrett argues that the JCC will be able to charge fees that are significantly lower than those at commercial health clubs because it does not have to pay property and gross receipts taxes. According to Garrett, these taxes alone cost just one of his clubs $27,000 last

SCOTT GARRETT

year. Garrett points out that while commercial clubs take financial risks and contribute to the tax base, JCC's and other 501(c)(3) organizations do not pay taxes and can accept tax-deductible charitable donations.

The inherent unfairness of tax-exempt organizations competing against tax-paying health clubs doesn't bother those running the Albuquerque JCC. Harold Alpert, attorney for the JCC, told the Albuquerque

NEW MEXICO, continued on page 6

Inside: IHRSA clubs post legislative victories...see page 3.

TAKING ON THE Y, continued from page 1

ing business. Clute wrote, "The taxpayers who pick up the burden for the tax-exempt YMCA Adult Fitness Center and the YMCA on Broadway should not be asked to smile and applaud at the same time (we) are secretly being forced to absorb the local, state and federal tax loss."

Clute's articles sparked a community debate. The Forum published several letters to the editor from Fargo-Moorhead residents questioning the Y's priorities. In one article, *The Forum* asked David Douglas, the Y's executive director, if the YMCA's expansion into the site of a former tax-paying health club was unfair competition in light of the $120,000 annually the Y receives from the United Way. Douglas responded, "It's not unfair competition for any business, whether for profit or not-for-profit, to do its job in the best way it possibly can."

Realizing that YMCA competition wasn't going to go away, Clute poured himself into his business in order to offer better service than the Y. In 1994, the YMCA announced its desire to build a $4.5 million adult fitness facility to be located within a mile of several existing commercial health clubs.

Ironically, at around the same time, the YMCA said that it would stop offering day care services for infants and toddlers. The reason, according to Douglas, "The day care center has not been financially solvent for the past two years and lost nearly $30,000 last year. . . until we figure out either how to generate additional subsidy money or have a higher demand for the center, it's just evidently not needed." This despite the fact that many area day care centers had waiting lists at the time.

This spring, Clute sent a letter to all area business owners about the YMCA.

In Clute's view, the cancellation of child care services at the Y clearly illustrates the Y's misguided priorities. Clute states "Rather than raising $30,000 to fund the needed day care, the Y's chose to initiate a public fund raising campaign for a $4.5 million fitness facility that will compete directly with taxpaying clubs."Even some of the YMCA's current members are unhappy with the Y. Earlier this year, one Y member contacted Clute after Y officials told him that certain locker rooms are off limits to children.

For Clute, the battle continues. Fund-raising for the YMCA's new facility is underway and construction is set to begin in early 1996. This spring, Clute sent a letter to all area business owners about the YMCA. In his letter, Clute wrote, "The Fargo Family YMCA is running commercial health clubs. . . (the Y) purchased one of the highest priced equipment lines in the market. . . (The YMCA) is making a conscious decision to attract upscale clients who could and would pay a higher price for membership." He ended his letter with this plea, "I am asking you to withhold your financial support from the Fargo-Moorhead YMCA."

Apparently, many have. Fund-raising for the new YMCA fitness facility is behind schedule. According to published reports, the Y is at least $2 million shy of its goal.

Is this a fight worth fighting? Without hesitation, Clute responds, "I believe in the free enterprise system. I am committed to preventing nonprofits from expanding further and competing unfairly with tax-paying businesses."

FG

Community Profile: Fargo, North Dakota

Population:	80,000 (approx.)
Number of tax-exempt health clubs (YMCA, Park & Rec):	4
Number of for-profit, tax-paying health clubs:	3
Total tax-exempt fitness related square footage:	247,000
Tax-exempt fitness related square footage previously operated by private, tax-paying businesses:	140,000
Total for-profit fitness related square footage:	62,800
Total tax-exempt fitness related square footage in the Fargo/Moorhead area if all the proposed nonprofit fitness centers/expansions are completed:	352,000

FAIR GAME

July/August 1995 The IHRSA Newsletter Of Fair Competition & Legislative Issues

LEGISLATIVE VICTORIES

Pennsylvania Senate Passes Charity/ Fair Competition Legislation

On June 26, the Pennsylvania Senate passed legislation to define a "purely public charity" for the purpose of granting state tax exemption. The legislation, Senate Bill 355, includes a provision that states that no charitable institution shall fund, capitalize or subsidize any new commercial business which "is unrelated to the mission of the institution and is in direct competition with an existing small business in the same community."

The senate voted 55-0 in favor of the fair competition provision.

For years, Pennsylvania IHRSA members have worried that this legislation, as originally drafted, would reverse the gains made by local governments to collect tax payments from certain nonprofit organizations.

Several IHRSA members including Frank Napolitano of HealthFit, Inc., Dave Cohan of the Sports Club and John Brinson of the Lehigh Valley Racquet and Fitness Centers spent considerable time and effort drafting the "fair competition" language that was included in the final version of the legislation adopted by the senate.

The senate voted 55-0 in favor of the fair competition provision.

Napolitano, who is the current president of IHRSA's board of directors, said that the Pennsylvania chapter of the National Federation of Independent Business (NFIB), endorsed the amendment and helped lobby for its inclusion in the bill.

To give you an indication of how much senators wanted to crack down on nonprofit abuses, the senate version includes a salary cap of $100,000 for the top executive at all nonprofit organizations in Pennsylvania, except those at state-related universities.

If the provision prohibiting competition with business remains in the bill, Napolitano believes that this legislation will prevent nonprofit organizations from expanding further into the fitness marketplace.

Senate Bill 355 must now pass the Pennsylvania House of Representatives, which is currently on recess for the summer. For a copy of SB 355, call IHRSA at (800) 228-4772.

Illinois Clubs Stop Park & Rec Legislation

The Illinois Coalition for Fair Competition, led by IHRSA member Alan Schwartz, was successful is defeating several legislative proposals to allow park districts in Illinois to circumvent voter approval for construction of additional fitness and tennis facilities.

The park districts also attempted, unsuccessfully, to exempt themselves from tax caps that are in place in several counties.

The Illinois Coalition for Fair Competition, with financial help from The Fund, hired the lobbying firm of Winston and Strawn to represent the club industry at the State House. According to Schwartz, the park districts were trying to get their legislation passed as late as 11 PM on May 25, the last day of the legislative session.

Schwartz says that this fight will continue in the fall if the park districts introduce additional legislation.

FG

IHRSA Advises Nonprofit Hospitals

On June 5, IHRSA sent a letter to over 790 [illegible] pitals across the country asking them to [illegible] the tax implications associated with operating a fitness facility.

In a letter to the chief financial officers of [illegible] IHRSA executive director John McCarthy [illegible] them free of charge a special report [illegible] Implications of Hospital Owned Fitness [illegible] by the public accounting firm Coopers and Lybrand. McCarthy said IHRSA commissioned Coopers and Lybrand to compile the report because "we [illegible] to take an unbiased look at when and under what circumstances hospital owned fitness [illegible] profit vs. non-profit."

The Coopers and Lybrand report [illegible] tions of hospital owned fitness facilities [illegible] tals should not organize health [illegible] careful consideration of [illegible] nonprofit hospital executives will [illegible] best interest to operate such fitness [illegible] sidiaries. For a copy of the report [illegible] Relations at (800) 228-4772.

FG

Ex-United Way Chief Sentenced to 7 Years in Prison

Federal Judge Claude M. Hilton sentenced former United Way of America president William Aramony to seven years in prison for spending the charity's funds on himself and his girlfriends. In addition, Judge Hilton denied Aramony's request to remain out of prison on bond pending his appeal.

Aramony and two associates were convicted after a four week trial in U.S. District Court in April. Aramony was found guilty of 25 counts of fraud, conspiracy and money laundering that is estimated to have cost the United Way of America $1 million in pilfered funds.

Winning Friends in West Virginia

Domenick Poster of the Spa Fitness Center in Bridgeport, West Virginia has taken IHRSA's advice to heart. Facing stiff competition from his local YMCA, Poster called IHRSA and asked for "The Fair Competition Handbook: An Effective Battle Plan for Club Action."

Since then, Poster and his staff have used the handbook as major resource in their efforts to educate community members about the negative impact that unfair competition has on a local economy. Using the model letters in the handbook, Poster wrote the YMCA board of directors, the county/city tax assessor and other city officials.

The result? Local television and newspaper outlets ran stories about the controversy over the YMCA's adult fitness center. Consequently, the YMCA was put on the defensive. In addition, many community members told Poster that they never realized that YMCA had an unfair advantage over tax-paying businesses, but now know better.

Small Business Votes 'Unfair Competition' as Top 15 Concern

Over 1,600 delegates to the White House Conference on Small Business met in Washington in June to ask Congress and the White House to stop government agencies and nonprofit organizations from competing unfairly with small businesses.

Small business operators from across the country considered over 400 issues that were reported out of 59 state meetings held during 1994 and 1995. IHRSA members Scott Garrett and Dave Cohan attended the White House Conference on Small Business and lobbied hard for unfair competition to be included as one of the conferences "Top 15" issues to be presented to lawmakers.

In the final vote, delegates cast 1,285 votes for the following statement. "Support fair competition: Congress should enact legislation that would prohibit government agencies, tax-exempt and anti-trust exempt organizations from engaging in commercial activities in competition with small business." Unfair competition ranked 14th out of all the issues considered.

IHRSA has developed a model letter on unfair competition you can use. For additional information, call IHRSA at (800) 228-4772.

The top issue among delegates, receiving 1,471 votes, was a call for Congress to cut the severe tax rules which force employers to treat independent contractors like employees. President Clinton, Vice President Gore, Senate Majority Leader Bob Dole and House Speaker Newt Gingrich all told delegates that they would work to enact the recommendations of the conference.

Senator Simpson Challenges AARP's Tax-Exempt Status

Senator Alan Simpson (R-WY) held hearings in June to investigate the American Association of Retired Persons (AARP). Simpson has charged that the AARP is abusing its tax-exempt status. Simpson believes that the AARP is a perfect example of how some nonprofits take advantage of their tax-exempt status to line their business coffers. At the opening hearing, Simpson pointed out that less than one half of AARP's $382 million budget comes from member dues, while the rest is generated through business activities.

The Wall Street Journal reported on June 14, 1995, that Simpson is "considering pushing legislation that would tighten the tax rules not only for the AARP, but also for other nonprofit groups." IHRSA believes that such legislation is long overdue.

During the week of the AARP hearings, IHRSA issued a "Call-to-Action" to forty selected club operators asking them to call or write Senator Simpson and tell him how unfair competition from tax-exempt organizations hurts their businesses.

At this time, IHRSA encourages all club operators to do the same. We hope to persuade Senator Simpson to broaden the scope of his investigation to include the business activities of other nonprofits, like the YMCA & JCC. National publications such as Business Week, USA Today and The New York Times have all called on Congress to look into this issue further.

IHRSA has developed a model letter you can use to help get you started. For additional information, call IHRSA at (800) 228-4772. Address letters to: The Honorable Alan K. Simpson, US Senate, SD 105 Dirksen Senate Office Building, Washington, DC 20510-5002.

FAIR GAME

July/August 1995 The IHRSA Newsletter Of Fair Competition & Legislative Issues

Fair Competition Help Available From IHRSA

Consultations

IHRSA can lend support to your fair competition fight. Call us and we'll tell you how.

The Fund

IHRSA will balance up to 50% of a legal or legislative effort for any members who meet The Fund's eligibility criteria.

Publications

- The Fair Competition Handbook: A Battle Plan For Club Action
- The Park & Rec Problem: A Threat to the Industry
- "The Tax Implications of Hospital Owned Fitness Facilities," by Coopers & Lybrand
- "Fair Competition in the '90's." An IHRSA position paper.
- The College & University UGIT Guidelines, a new fact sheet for clubs facing college and university fitness center competition.

Now!

- "Lifting More Than Your Own Weight: What Tax-Exempt Health Clubs Really Cost You." [illegible]

Quotes of Note:

How Non-Profit Groups Make Money, Avoid Taxes

"Some in Congress want to end tax breaks for whole categories of nonprofits, and other groups that get most of their income from business activities. A better way: Tax all non-profits' commercial ventures like other businesses.

Non-profits then could still take in donations and earn interest tax free, and make money like any business. Only they'd pay taxes on the profits, rather than stick other businesses and tax payers with the bill."

USA Today editorial
June 20, 1995

It's Open Season on Nonprofits

Their ringing cash registers have Washington up in arms

"They call it The Yuppie Y: eight gleaming floors of designer exercise machines, squash courts, an Olympic-sized swimming pool, a virtual reality golf course, and a multi media nautilus room right smack in the middle of downtown Washington. You can even get your Guccis polished while you work out."

Business Week
July 3, 1995

Nonprofits' Fat Profits

"Businesses are entitled to a level playing field, and Congress and the IRS should see to it that the profits of nonprofits are taxed just like the profits of regular businesses."

Business Week editorial
July 3, 1995

FAIR GAME

The IHRSA Newsletter Of Fair Competition & Legislative Issues July/August 1995

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Frank Napolitano
HealthFit, Inc.
Ray O'Connor
Waukesha Athletic Club
Jim Gerber
Western Athletic Clubs

NEW MEXICO, continued from page 1

Journal, "It's of no consequence to us whether or not Scott Garrett is for or against the manner in which we are proceeding with our (fitness facility) development. The Jewish Federation of Greater Albuquerque complies with all tax laws . . . If we didn't comply, it would be up to the taxing authorities to tell us to change our activities, not Scott Garrett."

For his part, Garrett recognizes that the place to effect change is at the Internal Revenue Service. He has sent the IRS detailed information about the Albuquerque JCC and has asked them to re-evaluate the JCC's tax-exemption.

"I'm not against Albuquerque's Jewish community as some people believe," said Garrett. "I'm trying to preserve our for-profit industry." Although the JCC has not stated so publicly, Garrett believes that the IRS has denied tax-exempt status for the planned fitness facility, and that the JCC is appealing this decision. Garrett believes that eventually a court will decide the status of the JCC's tax-exemption.

"Today, people are reaching into other people's pockets by promoting themselves as a charitable organization in order to build their dream health clubs," said Garrett. "If an individual or group wants to operate an upscale club, let them go to the bank and put their house, car and future on the line just like we have done."

Garrett's commitment to this issue goes beyond his own community. Earlier this year, he started a separate company, called U.B.I.T. WATCH, to focus exclusively on unfair competition. The company's name comes from the federal tax nonprofits are supposed to pay on any revenue that is unrelated to their charitable mission, called Unrelated Business Income Tax or U.B.I.T. Garrett said that he has received calls from nine different club owners across the country who are battling unfair competition.

According to Garrett, when club owners hear about a new JCC or YMCA fitness facility, the worst thing they can do is to do nothing. He encourages all IHRSA members to fight for their rights as taxpayers. To learn more about how you can combat unfair competition call IHRSA at (800) 228-4772.

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IHRSA gives $12,650 to Massachusetts Club Effort

IHRSA will spend $12,650 to combat unfair competition in Massachusetts. Specifically, IHRSA has approved an application by the Massachusetts Coalition for Fair Competition (MCFC) for financial assistance from The Fund, IHRSA's legal and legislative account.

The MCFC was formed last year by club operators concerned about the growth of unfair competition in Massachusetts. The MCFC is developing a multi-faceted strategy to address local unfair competition from nonprofit organizations like the YMCA, JCC and several colleges and universities. As part of that strategy, MCFC plans to file zoning complaints in all applicable cases; publicize and expose violations and abuses by tax-exempt institutions; and initiate action against any institution that has not filed appropriate documentation for annual renewal of its charitable tax-exemption.

In order to receive a grant from The Fund, local IHRSA members must finance at least 50% of the cost associated with a fair competition or legislative effort. To date, the MCFC has received $14,400 from several Massachusetts IHRSA/NEHRSA clubs. Contributors include The Boston Athletic Club, Cedardale Athletic Club, Dedham Racquetime Athletic Club, Fitcorp, The Fitness Club for Women, Orchard Hills Athletic Club, The Plymouth Athletic Club, The Suburban Athletic Club, The Squash Club, The Thoreau Club, Waverly Oaks Athletic Club, The WellBridge Company and The Weston Racquet Club.

IHRSA hopes that the techniques used by the MCFC will prove successful and can be used by club operators nationwide to combat unfair competition. In addition to Massachusetts, over the past year The Fund has support club efforts in Utah, Ohio, Illinois and Rhode Island.

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October 31, 1995

U. S. News & World Report
Editorial Office
2400 N. Street N.W.
Washington, D. C. 20037-1196

Re: Cover Story - October 2, 1995

Your article concerning the tax exempt organizations in America was of great interest to me. The facts and figures should stimulate the American taxpayer to a new level of awareness. The injustice of the not-for-profit regulations is of major concern to me as a private sector businessman.

Your research and subsequent comments about organizations like the PGA tour, Underwriters Laboratories and the others that have manipulated the system for profit are but a few that are politically safe to mention.

Yes, the PGA tour earnings last year were $180 million and yes, they only paid $63,534 in UBIT taxes. Yes, 1.1 million organizations claim tax exempt status, and yes, 5% or 44,890 reported UBIT taxes in the amount of $373.4 million, but no mention was made of the organization that generated $1.2 BILLION last year.

That organization is the **YMCA.**

If it were a for-profit business, it would have ranked No. 295 on **FORTUNE** Magazine's Fortune 500.

In your article you mentioned the salaries of the executives of many tax exempt groups and organizations being, on average, six figures. In a recent article in the Chicago Sun Times ("What Top Non-Profit Groups Pay"), they stated the salary of David Mercer, the Executive Director of the Chicago area YMCA's, as $240,364, with additional benefits of $28,853.

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U.S. News & World Report
October 31, 1995
Page 2

I am more than casually concerned about the growing encroachment of the YMCA organization into the private sector. I have been associated with a major health and fitness facility in the midwest for the last eleven years. I have seen first hand how the YMCA has positioned themselves as direct competition in the fitness industry. The struggle between the fitness industry and the YMCA has been a major focus since the early 1980's.

IHRSA, International Health Racquet Sports Association, has been in the forefront of this battle. IHRSA, is the industry association that established the standards under which quality clubs function. In 1991 IHRSA copy righted "Fight Back", the fair competition handbook. A copy may be obtained from IHRSA by calling 800-228-4772. This publication will help you understand the struggle that goes on each business day through out the fitness industry.

Many independent health club owners have taken on the challenge personally, in an attempt to establish a fair standard of operation as it relates to not-for-profit groups like the YMCA. To give further credence to the problem you may contact any of the following:

Scott Garrett	505-881-8338
Peggy Chirvan	314-364-6466
Roger Ralph	410-838-2670
Helen Durkin	800-228-4772
John McCarthy	800-228-4772
Sharon Sporman	219-865-6969

The list of concerned health club owners goes on and on. So does the abuse of the tax exempt status of the YMCA.

The YMCA is, when it follows its basic mission statement, a very worthwhile organization. We feel in the fitness industry, the YMCA has lost its focus and has drifted from its basic mission. There is no doubt that they have emerged from the long established shelter of "Not-For-Profit" to become a competitive force to be reckoned with. They can no longer be considered the "Sacred Cow" and must be challenged.

In the event of further research by your organization into the tax exempt dilemma, I will eagerly make background information available to you upon your request.

Thank you for taking the time to review these aforementioned comments.

You may contact me at Omni 41 Sports & Fitness Centre, 219-865-6969.

Very truly yours,

John M. Kohan

John M. Kohan
Community & Corporate Relations

JMK/sw

August 2, 1996

The Honorable Jan Meyers
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Madame Chairman:

Because of the impact unfair competition (tax-exempt facilities such as the YMCA/YWCA) has had on my club, I am requesting that you submit this letter to the House Small Business Committee for its official record regarding the unfair competition hearings held in July, 1996.

Substantial losses (10-15 %) in revenues because of unfair competition can be directly attributed to a decline of potential and existing members to less expensive YMCA/YWCA's both within 3-5 miles of my club. The YMCA has expanded its original location so immensely that it has begun opening "extensions" in extremely close proximity to my club. As well, the YWCA has recently expanded its present location.

At this time I urge you to address this issue and provide small businesses with protection from nonprofit organizations. I recommend the following:

> The US Treasury should be required to provide a public estimate of revenues lost through nonprofit organizations' avoidance of Unrelated Business Income Tax (UBIT).
>
> Congress should authorize the General Accounting Office (GAO) to undertake a study to determine the extent to which nonprofit health and fitness centers actually serve needy individuals and charitable classes.
>
> The Small Business Committee should call on their colleagues in Congress to clarify the tax laws governing commercial activities by tax-exempt organizations.

I am grateful for your regard in this matter as we have suffered considerably from unfair competition for too long!

Sincerely,

Richard Masia
President
Murray Hill Health & Racquet Club

593 CENTRAL AVENUE • MURRAY HILL, NJ 07974 • (908) 665-1141 • FAX (908) 508-0532

MOORE'S Fitness

August 1, 1996

The Honorable Jan Meyers
Committee on Small Business
U.S. House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Madame Chairman:

I am requesting that this letter be part of the official record of the upcoming unfair competition hearings.

I have been in the Fitness Industry for 26 years, and I enjoy meeting competition head-on. However, my main competitors are no longer private sector health clubs, but multi-million dollar palaces built by cities, YMCA's, and Jewish Community Centers. They target my members for recruitment, they aggressively try to hire my employees, and they copy my programs.

Because of their tax exempt status these health clubs can offer memberships at prices well below the market rate. Some of the city recreation centers sell full health club and swimming programs for $49.00 a year; these programs are not for indigent children but for suburban YUPPIES. How can the memberships be so cheap? They use my tax money to unfairly compete against me!

In Dayton Ohio there have recently been three major nonprofit health clubs built. The result was the closing of over half of the private-sector clubs. I could relate hundreds of horror stories about the cut-throat tactics used by the nonprofit clubs if you would like details.

P.O. BOX 751023 • DAYTON, OH 45475-1023 (513) 435-0072 • FAX (513) 435-7736

The Honorable Jan Meyers
August 1, 1996
Page 2

However, the Treasury Department should provide a public accounting of taxes lost by the nonprofits exemption from Unrelated Business Income Tax. A study should be conducted of nonprofit health clubs to determine if they really help the needy, and Congress needs to clarify the laws relating to commercial activities of tax-exempt businesses.

I appreciate your consideration and hope for your help.

Sincerely,

Sidney J. Moore
President

SJM/leh

DECATUR
ATHLETIC
CLUB

August 1, 1996

The Honorable Jan Meyers
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Madame Chairman:

I would like to request that this letter be submitted to the House Small Business Committee for its official record regarding the unfair competition hearings held in July. I am the owner and operator of Decatur Athletic Club in Decatur, Illinois. I have owned the Club for 22 years and over that time have invested over two million dollars in this business. Annual revenues exceed $1,300,000.00 and we employ 60 people in part-time and full-time positions. The Club pays Real Estate taxes of $20,000.00 per year and my wife (who works elsewhere) paid over $60,000.00 in Federal and State Income taxes last year. We are happy to pay our fair share but extremely unhappy when we have to compete with tax-exempt organization that serve the same market we do.

We currently compete with both the YMCA and YWCA along with Richland Community College. Richland Community College currently offers memberships to their fitness facility at substantially reduced rates under the guise of a non credit course. This non-credit course does not meet at a particular time and does not have an instructor. It is clearly a membership. I have contacted the President of the College to see if they were paying their Unrelated Business Income Tax. They do not file such a tax. We have lost potential members to them. Richland also offers Aerobic Classes to the general public in direct competition to us. Last Christmas season they aggressively advertised their membership through the mail.

Our Park and Recreation Department of the City of Decatur aggressively offers competing services that we offer. (Aerobic Classes, Swimming Lessons, Tennis Lessons, etc.) The competing YMCA can offer their services at substantially reduced rates because of their tax exempt status. I truly wonder how much charity or low cost programs they offer to the underprivileged to qualify for such an exemption.

I do not have exact figures on the business we lose to Non-Profits but I would estimate it to be two to three hundred memberships each year. This translates to revenue of about $225,000.00.

DECATUR ATHLETIC CLUB 1010 South Side Drive • Decatur, Illinois 62521 • Phone (217) 423-7020

Congress should address the issue and provide small businesses with protection from unfair competition from non-profits. I recommend that the following be instituted :

1. The U.S. Treasury Department should be required to provide a public estimate of revenues lost through non-profit's avoidance of Unrelated Business Income Tax.

2. Congress should authorize the General Accounting Office to undertake a study to determine the extent to which nonprofit health and fitness centers actually serve needy individuals and charitable classes.

3. The Small Business Committee should call on their colleagues in Congress to clarify the tax laws governing commercial activities by tax-exempt organizations.

The health of the vibrant fitness industry is at stake if the nonprofit organizations are allowed to continue to invade markets which are not in their primary mission.

Sincerely yours,

Robert C. O'Connell

August 5, 1996

The Honorable Jan Meyers
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Madam Chairman,

I am requesting that this letter be submitted to the House Small Business Committee for it's official record regarding unfair competition hearings held in July 1996.

I have personally experienced competition from a nonprofit organization, the YMCA. My fitness club, the Yreka Fitness Center, was greatly impacted by the YMCA. Not only did I experience a drop in memberships by 20%, they also came into my business under false pretenses soliciting my members and my employees. I also found that my tax dollars were funding a loan to the YMCA made by the City of Yreka. This is after they already received nearly 1 million dollars in donations. Yreka owns the building that they are operating out of charging them only $1.00 per year rent. Utilities paid by the utility companies and office furniture handed to them free of charge. At a city council meeting in October 1995, a YMCA board member, Dave Caulkins, openly admitted that they were in fact competing with my business and that the community should get used to the idea.

The YMCA wants to operate under the guise that they want only to assist children by providing children's programs. Yes, they offer programs, but they are incredibly expensive, nothing is free. They also provide adult and senior programs, personal training and aerobics classes which is what my club has always offered. So far, I've seen the "Y" with their hand out. The consensus is that this community is fed up with it.

Who helps me when the utility bill arrives and I'm short on cash, the copy machine breaks down, the mortgage is due, payroll needs to be met, no one. The YMCA not only gets all the "freebies" but I get the privilege of assisting them with my tax dollars. The public doesn't know that the YMCA is the largest fitness organization in the world and here I am supplementing it.

Suggestions:

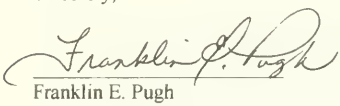
> I strongly urge Congress to address the issue and provide small businesses with protection from unfair competition from non-profits.
>
> The U.S. Treasury should require to provide a public estimate of revenues lost through non-profits' avoidance of Unrelated Business Income Tax (UBIT).

Congress should authorize the General Accounting Office (GAO) to undertake a study to determine the extent to which nonprofit health and fitness centers actually serve needy individuals and charitable classes. (A similar study of nonprofit hospitals showed that they often serve fewer indigent or needy cases than for-profit, taxpaying hospitals.)

The Small Business Committee should call on their colleagues in Congress to clarify the tax laws governing commercial activities by tax-exempt organizations.

Please, I'm a small business owner with a family to support. I also support this community and my country by paying my taxes. I am forced under those circumstances to aid my competition. Do you have any idea how upsetting that is?

Sincerely,



Franklin E. Pugh
Yreka Fitness Center/Owner/Tax Payer
213 Greenhorn Rd.
Yreka, CA 96097
916/842-1208 FAX 916/842-1220

glcma

Shellie Sanders
Great Lakes Club Mgt. Association
6622 Shelley Dr.
Clarkston, MI 48348

July 26, 1996

The Honorable Jan Meyers, Chair
Committee on Small Business
Unites States House of Representatives
2361 Rayburn House Office Building
Washington D. C., 20515

Dear Representative Meyers:

The Great Lakes Club Management Association (GLCMA) is composed of for-profit health, fitness, and racquet clubs in Michigan, Ohio, and Canada. We are a regional affiliate of the International Health, Racquet, and Sports Club Association (IHRSA).

Many of our clubs are threatened by unfair competition from YMCAs and other non-profit organizations. The enclosed report was written by Scott Garrett of U.B.I.T. Watch, Inc., for GLCMA, concerning the development of a new facility, the North Oakland Family YMCA. Mr. Garrett's study shows how a number of for-profit clubs in the surrounding area could be adversely affected by the YMCA. Further, he shows that there are other locations where the Y's services would better fit the needs of the population.

I thought this report may be of interest to you. Thank you for your consideration in this matter.

Sincerely,

Shellie Sanders

Executive Director

Great Lakes Club Management Association

June 10, 1996

Mr. Larry Scramlin
Executive Director
North Oakland County YMCA
EIN 38 1358237
957 Miller
Lake Orion, MI 48362

Dear Mr. Scramlin:

It has come to our attention that you are planning the construction of a large swim/fitness and recreational facility in the Auburn Hills area of Michigan.

Per Internal Revenue Service requirements, you are to notify them if: "..... your source of support, or your purpose, character, or method of operations change.....". This new facility falls under this requirement, and as such, a determination letter from the Internal Revenue Service should be received prior to the start of construction. Such a letter would ensure the tax deductibility of the donations received.

The Internal Revenue Service is being notified by a copy of this letter that a recreational complex, significant enough in size to be judged independently of all your other activities, is being built on a new site. In that recreation is not enumerated in the 501(c)3 category, but is enumerated both in 501(c)4 and 501(c)7 it stands that contributions to build such a complex might not be tax deductible and that income received from said facility could be subject to unrelated business income tax (U.B.I.T.).

It should be known that recent Internal Revenue Service publications reaffirmed that income from general public to use recreational facilities at 501(c)3 educational entities is subject to U.B.I.T. Also, a recent tax court case, Spanish American Cultural Center vs. Commissioner reaffirmed previous cases (Schoger vs. Commissioner, Columbia Park vs. Commissioner), that recreation and/or social facilities are not 501(c)3 tax exempt.

In so much that well over 51% of your facility is planned to be recreational/social in nature, with less than 10% designated exclusively to educational or charitable child care activities, your facility could fall within a recreational purpose with incidental educational/charitable usage.

Should you build this facility without obtaining IRS approval specific to this new complex, you could be jeopardizing your present tax exempt status and those donations entrusted to your care to build this new recreational facility. Board members need to ensure that the YMCA complies with and obtains all IRS approvals prior to accepting and using contributions to build this new facility.

All plans, specifications, sources of funding and a description of all activities to be offered at this new complex should be submitted along with your application to the following address:

Internal Revenue Service
EP/EO Division
135 High St.
Hartford, CT 06103

We have mailed non-registered letters to your Board of Directors and request that you make copies of this letter available to other individuals on the Capital Campaign Cabinet.

This letter is to ensure that you properly seek the approvals necessary. The fact that your sources of income have significantly changed between the years 1993 and 1994 (source: 990 tax forms) indicates a need to notify the IRS of your intentions per existing IRS requirements and per the letter sent to your organization by the IRS when initial tax exemption was granted. A copy of the standard IRS approval letter is included. We recommend to your board that they seek the advice of an independent tax councilor and not rely solely on the past activities of a tax-exempt organization or the opinions of the employees of such an organization.

We thank you in advance for your compliance.

Sincerely,

Scott Garrett, Director
U.B.I.T. Watch, Inc.

cc: Regional Internal Revenue Service Office
National Internal Revenue Service Office, Washington DC
YMCA Board of Directors

U.B.I.T.
WATCH

PO Box 36269
Albuquerque, NM 87176-6269
(505) 881-8338

Re: New Construction by Auburn Hills YMCA
(EIN #38-1358237)

Internal Revenue Service
EP/EO Division
135 High St.
Hartford, CT 06103

June 10, 1996

Dear IRS:

The Auburn Hills YMCA is planning to construct an $8 million recreational club in the affluent sector of Auburn Hills, Michigan. This facility is being built with 501 (c)3 charitable funds and is promising contributors tax deduction on funds given. It is our belief that the facility proposed at the location selected will not qualify for full tax exemption under the present IRS guidelines for exemption (cite: 94 TNT 41-57).

We ask the IRS to review this proposed development with these questions in mind:

1) Cross-section - Information provided by YMCA shows the primary concerns of the organization did not involve, in any fashion, a desire to locate this facility in an area which would attract a demographic cross-section of the community.

2) Charitable limits - Published material shows their intent is only to extend 5% of its total membership to reduced or subsidized usage - not sufficient enough to exempt 95% of its income.

3) Duplication of service - Presently ample facilities exist in this area, both public and private, to satisfy the needs of the community. These facilities, including a large community college complex, fulfill the need for medically supervised exercise. Additional facilities will substantially impact the revenues of the existing facilities, resulting in tax losses by the private operators and government subsidies required by the public facilities. As a result public benefit would be negatively impacted.

4) Fragmentation rule removes exemption - The facility planned will cater primarily to people wishing to purchase recreation. People

of little means will be limited to 5% of usage, over 70% of structure and income will be derived from recreational club usage. "Community benefit" is presently served by other facilities. A combination of charitable, educational and religious usage will only constitute less than 1/3 of the facility budget, thus failing the "related to" test for exemption.

5) Commercially comparable fees - The YMCA rate structure, when compared to the fees assessed residents by the community college and the proposed university sports facility is excessively high. Currently plans are for the YMCA to charge $38-90 per month or $5.00 per visit for health club usage. The community college allows community residents free access and others $2.50 per visit. Both facilities provide access to medically supervised wellness, and while the facilities might differ, the results to the body are the same. Any comparisons done by the IRS should:

a. Compare public tax supported facilities to each other. Comparisons between paying and non-tax paying should not exist unless a credit is factored into the tax paying rates, to offset the impact of taxes and construction through tax exempt contributions versus debt accumulation.

b. Information provided in the appendix of this material will show that the $3,000 recreational expenditure figure used in 94 TNT 41-57 is incorrect and should be immediately suspended from use by the IRS. This information provided to the IRS was false. According to the 1986 US Statistical Abstract the average American consumer has only $2498 for total "other" expenditures, which includes recreational usage (see Appendix A). Based on the fact that recreational expenditures makes up only a fraction of this amount, the previous information provided to and used by the IRS is incorrect. In that only 8% of the discretionary income, or roughly $200, is used toward health club costs the average expenditure on health clubs lies far below the YMCA's fee of $430-$800 and this facility will be beyond the means of the average American.

Additional facts and supportive information is included. In that the Auburn YMCA is significantly changing its source of income and is changing its purpose, by certified letter we have notified the board of directors and the executive director of their need to notify the IRS of this change. We ask the IRS to review the enclosed information provided by the YMCA and rule that their proposed facility qualifies under 501 (c)4 or (c)7 for tax exemption.

We feel the scarce charitable dollars which exist in the community can be used better in other areas of need than in building what appears to be a health club/country club for the more affluent of

our society. We feel that US Tax Court Cases and the US Tax Code protects the tax paying clubs from "unfair" competition (see "When is recreation 501(c)3?"- Appendix J).

We ask the IRS to review its policies of audit and realize that failure to protect private industry from "unfair" competition produces financial losses to private providers. We ask for your assistance in this particular area of the country.

Sincerely,

Scott Garrett
U.B.I.T. Watch

Representing several tax-paying recreational facilities in the Auburn Hills area.

Issue #1: YMCA will not serve a large enough population.

Support material:

"...indefiniteness of beneficiaries is not only characteristics of, but is an essential element of a charity." *Russell vs. Allen 107 US 163; Freshour's Est 354 P. 2nd 689;*

" A trust is not a charitable trust if the persons who are to benefit are not of sufficiently large or indefinite class so that the community is interested in the enforcement of the trust." *Scott on trust 3rd 369.5*

" But a trust unconnected with the relief of poverty or the advancement of education or religion or health in order to be charitable must be for the benefit of a larger class than needed be benefited if the trust is connected with such purposes." *Scott on trust 3rd 375.2.*

Public to be served:

- Based on information provided by the YMCA in its publication, *Yes We Can*, only 4-7% of the population of Auburn Hills will use the YMCA (see appendix B). This concurs with an IHRSA/ASD trend report which shows that less than 8.6% of Americans belong to health club type facilities, including YMCA's (see appendix C). Factoring in the number of competing facilities within a 3 mile radius of the planned site, the YMCA will serve less than 5% of the population, and with less than 5% of those memberships to be of a charitable nature.

Arguments:

- The planned YMCA is unconnected with relief of poverty, education, religion or health (in the sense the IRS describes health i.e. reactive medicine). With this established, the YMCA should serve a larger class of people than do churches, symphonies, theater or schools. It is our contention that serving 2-5% of the population is not wide enough to warrant "charitable" tax exemption.

- While symphonies might cater to 1-2% of the population, these symphonies are connected to one of the bonafide purposes outlined in 501(c)3 exemption (i.e. education), the YMCA activities are permitted under existing 501(c)4 and 501(c)7 categories. To be "charitable" it must serve a much larger class of population than to those activities listed in 501(c)3. We feel such an organization should not only be "available" to serve a large section of the

population but demonstrate that they do serve a large percentage of the population, and 2-5% is not sufficient.

Issue #2: Not designed to serve community cross-section.

Support Material:

In the feasibility study by the North Oakland County YMCA several criteria were considered for the final site selection. Nowhere in this discussion did they factor in whether a site provided the ability of attracting a community cross-section (see appendix D).

Criteria for site selection by the North Oakland YMCA planning comrnittee established and weighted the criteria in this order of importance:

Criteria	Importance
Philanthropy	60%
Probability of Lease	20%
Convenience	10%
Proximity	10%

Definitions:
Proximity - high density population
Convenience - users to drive to site easily
Philanthropy - available to support a site
Probability of lease - availability to obtain a site.

It is obvious from all of the material and comments made in the feasibility study for the Auburn Hills YMCA, that the primary consideration for site selection was monetary, not charity. The Auburn Hills YMCA did not seek to select a site which weighted the requirements established by the IRS in *Tax Notes Today* 94 TNT 41-57 (March 2, 1994). The Auburn Hills YMCA did not seek to locate a site which would serve a community cross-section and ultimately selected a site far removed from pockets of poverty to fulfill the established IRS guidelines.

Pontiac YMCA closed: This same YMCA recently closed a much needed and utilized facility in Pontiac, MI only 5 miles away from the new site (see location map from *Yes We Can* - appendix E). This facility primarily served those of lower financial worth and was indeed filling a "charitable" purpose. The Pontiac demographics show it a much better location to serve a community cross-section. The facility is still empty and available (see photos in appendices).

The fact that the YMCA of Auburn Hills places so much emphasis on locating in a wealthy area where "more than 60% of target households have an

income greater than $35,000" shows that their concern for reaching the poor is almost non-existent (see appendix F). Nowhere in their discussion or decision existed concerns about locating near individuals with financial need.

In the study for convenience the primary factor considered was access by private vehicle "user to drive to site easily." Again, no consideration for bus routes or mass transit were considered. Removal of public transportation places a barrier of access upon those at lower income levels.

Issue #3: Donations reflect Private Inurement.

Julian Wolpert of Princeton University recently identified that money to inner-city charities has stopped from the suburbs because in part, people in the suburbs have discovered they can be the recipient of their own charity. This YMCA is a classic example of people giving to themselves.

In private for profit recreational clubs 20-40% of operating costs are associated with debt expenditures. The elimination of debt allows dues to be 20-40% less than if normal debt existed. Exempt contributions eliminate debt thus reducing dues, providing a form of private inurement. If a family membership can be reduced 30% due to giving a tax deductible contribution and average dues for similar type YMCA's range $70-80 per month, the private inurement received by the giver who joins the YMCA would result in a savings of over $200 per year.

Whereas 501(c)7 recreational clubs receive no tax deduction for contributing $1000 to join a club, a YMCA member of Auburn Hills will contribute $1000 and take a tax deduction, then receive $200-300 per year in dues savings. A return on such a gift represents a 30-40% investment in savings. Private inurement occurs because those who join receive an annual rate of return of over 30% on money given to build the facility.

While such giving occurs in churches and schools, the reality is such gifts fulfill bonafide 501(c)3 purposes (i.e. educational, religious etc.). Giving to an organization which is "recreational" does not fulfill a bonafide 501(c)3 purpose unless such a gift is "charitable" in nature. Receiving a reduction in dues is not "charitable". This facility is not free to all residents of the community nor is it being built primarily for the children and those who otherwise could not have access, both of which existed in Isabelle Peters vs. Comm. (21 T.C. 55).

> Horace Binney defined charitable trust as "whatever is given for the love of God, or for the love of your neighbor, in the catholic and universal sense-given from these motives and to these ends-free from the strain or taint of every consideration that is personal, private or selfish." *Vidal vs. Girard's Executors 2 How.12711 L. ed 205 (US1844).*

> "...benefits in the form of food, clothing, shelter, medical, education, services and recreational facilities constitute a private not a public purpose as well as private not a public purpose as well as private inurement." *Beth-El Ministries vs. U.S. 44 AFTR 2d 79-5190 Bubbling Well Church 670 f.2d 104.*

We ask the IRS to determine what percentage of the donations given to build this YMCA are coming from people who live within the 5 mile target market the YMCA has identified as their primary market.

If the majority of givers become users then either it should lose its charitable exemption or a value received amount should be deducted from their tax deduction as per required in IRS rulings.

Issue #4: Facility is primarily recreational not charitable.

As stated in a video, in public testimony, when asked what percent of the proposed new facility would be considered recreational the YMCA stated to the Auburn Hills City Council: **"100%."** See appendix K for partial transcription of the Council meeting. (Video is included for your review.)

Based on the conception master floor plan for Auburn Hills (located in *Yes We Can* - see appendix G), the percentage of gym, locker room, weight rooms, racquetball courts, swimming pool, wellness center etc. represents over 60% of the entire building's square footage. The remaining 40% is for the senior center, day care, teen areas and offices. As such, the facility is predominantly recreational in nature.

Based on projected annual income, less than 5% is expected to come from direct or indirect donations. About 45% of revenue is expected to come from programs and 38% from dues. Dues are a requirement for using the facility. Less than 5% of membership will receive financial assistance as stated by the YMCA in its private literature.

> "A social club operated for the benefit, pleasure or recreation of its members carrying on of a business with the general public in a manner similar to organizations which are operated for profit is not qualified for exempt status under section 501(c)4." *Tax Exempt Organizations*, E.C. Lashbrooke Jr.

Issue #5: Sufficient recreation is available in Auburn Hills.

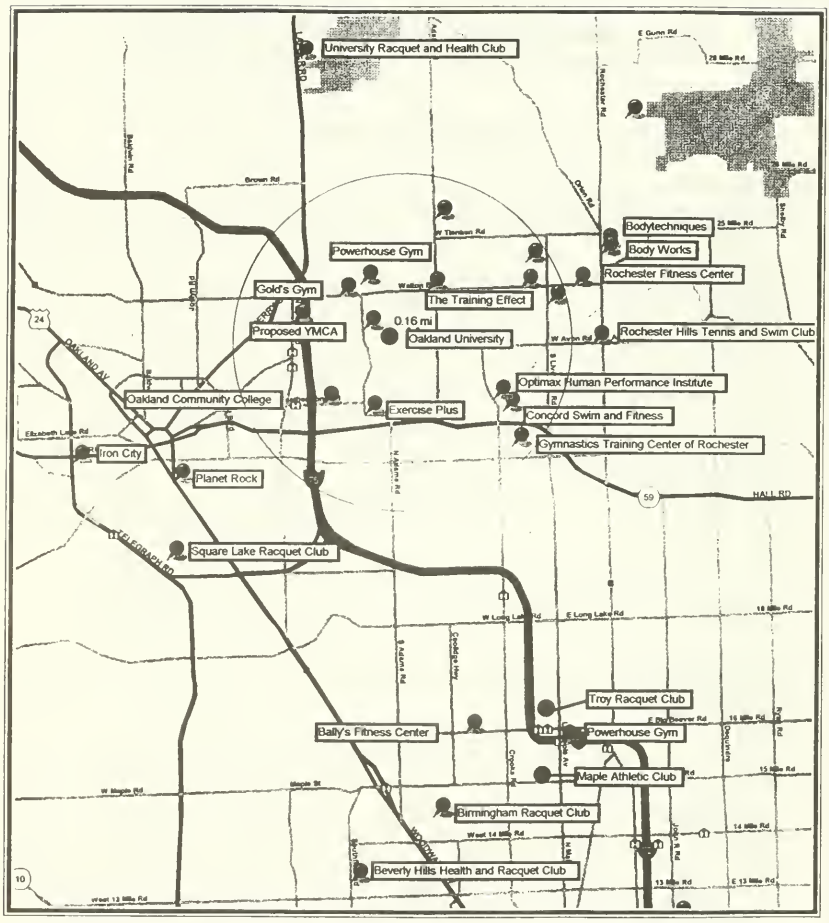
Presently within a 3-5 mile radius of the proposed Auburn Hills YMCA site there exists sufficient recreational outlets to adequately serve the area. Oakland University (1/2 mile away) is planning to build a new $38 million state of the art recreational complex open to the public. In addition, the Oakland Community College (1 mile away) offers recreational use for free to residents of Auburn Hills with a pass. On the following pages a facility comparison charts the available recreation sites or public facilities located within a 3-5 mile radius of the proposed YMCA site, with a map showing these recreational sites.

Within 3 miles of the proposed YMCA there are over 19 childcare facilities with available room to serve more children.

FACILITY COMPARISONS

	Miles from proposed YMCA site	Single Adult per Month	Aerobics	Weights	Cardio Equip.	Pool	Basketball	Racquetball	Childcare
Proposed YMCA	N/A	$38.00 (approximate)	x	x	x	x	x	x	x
Oakland University Lepley Club	0.5	$12.50		x		x	x		
Oakland University Health Enhancement Center	0.5	$30.85		x	x				
Oakland Community College-Auburn Hills Campus	1	$2.25/visit free to comm. residents		x	x			x	
University Health Club	5	$40.00	x	x	x			x	
Rochester Fitness Center	4	$37.85	x	x	x		x		x
Powerhouse Gym	1.25	$29.00		x	x				
Concorde Inn	3	$40	x	x	x	x			
Gymnastics Training Center of Rochester	3.25	$46-$85	n/a						
Optimax	2.75	$33 - $100		x	x	x			
Iron City Gym	5	$16.58		x	x				
Square Lake Racquet Club	6	$19 Tennis	n/a						
Body Techniques	4	$75	x	x	x	x	x	x	x
Fitness Factory Aerobics Only	3	$30 - $49 per 10 weeks	x						
Planet Rock Rock climbing	3.5	$25 rental fee	n/a						
Bodyworks	3.25	$55	x	x					x
Rochester Hills Tennis & Swim Club	3	$17.50 plus court time	x			x			

Current Map



●-FITNESS FACTORY LOCATIONS

1/2" = 1 mi. (approx.)

Issue #6 Auburn Hills YMCA fees to exceed the average cost of comparable available recreation.

Monthly membership costs at the proposed YMCA will be approximately $38.00 per adult. The average cost of recreation in tax exempt operations or governmental facilities in the Auburn area is $14.45 per month. When including private facilties the average cost is $32.00 per month. The YMCA's fees are above the affordability of the typical consumer, especially given the fact that public facilities are availabe at a much lower cost.

Issue #7 Public Benefit less than Public Cost.

The City of Aubum Hills is essentially giving the YMCA free land in exchange for the YMCA's acceptance of providing a Senior Services facility and activities. This appears to demonstrate that the YMCA is lessening the burdens of government, however, closer scrutiny might show otherwise.

- Services or ongoing costs are equal to the debt cost associated if the YMCA were to purchase the land. The amount of proposed free service (less than 5%) is less than the annual debt that would have occurred had the YMCA purchased the property.

- The impact on the existing tax paying businesses which will compete with the new YMCA will result in financial losses to those businesses resulting in an income tax loss and a property tax loss. This cost will be a burden on tax payers who will lose those taxes once generated by those for-profit businesses.

- During the Capital Campaign $6 million which might have flowed to homeless shelters, food banks or more deserving charities will be diverted to build this $100 per square foot YMCA facility (see appendix H). To offset this loss to traditional charities, government might have to step up its contributions to these charities.

- After constructed, the YMCA will seek over $50,000 per year from the local United Way, further impacting more traditional charities which government has always supported, such as Boys & Girls clubs, homeless shelters, relief institutions and healthcare providers.

The area designated for the senior center is less than 15% of the facility. The remainder of the facility should be "fragmented" and judged separately. The senior center is incidental and insufficient in size to give exemption to the entire site.

Issue #8 Purpose may be fulfilled with less expense.

The YMCA is projecting to spend over $100 per square foot to build this new facility, excluding land and equipment costs (again see appendix H). The services planned to be offered need not be offered in a shiny chrome and marble environment. More wellness, youth and senior activities may be provided in a less expensive building. In place of one fancy facility the YMCA could serve a larger mass of people by building less expensive buildings of the same size in two different parts of the city.

Construction can be accomplished through the use of metal buildings and less frills for $50 per square foot leaving $3 million to re-open, renovate and subsidize the closed YMCA in Pontiac, which served the poorer community.

The building of such a fancy, high cost facility will only make those who are less fortunate uncomfortable in attending the new site. Such an upscale facility will create a barrier of discomfort to those of little means.

Issue #9 Contribution by primary donor is self serving.

In the executive summary of the site selection package, it was pointed out that there existed a "potential lead gift of 30-35% of the total project if the project is constructed at this site" (see appendix I). This gift would be by a major corporation with large employment in the area.

A requirement to locate the facility in a particular area removes the "unselfish" nature such giving is supposed to have. It is our belief that the donation is a form of private inurement through reducing employee health costs via wellness programming to be conducted at this new facility.

> "A number of businesses are finding that having a fitness center or subsidizes athletic club membership serves as a recruiting aid..." *(U.S. News and World Reports, America Fitness Binge, May 3, 1982)*

> " Officials of the Battelle Memorial Institute conducted a survey that showed employees who used the fitness center at the firm's Columbus, OH laboratories averaged 28 days less absenteeism than those who did not. The total savings in reduced absenteeism costs amounted to approximately $150,000 per year." *(ibid.)*

> " Tenneco, Inc. built an $11 million fitness center next to its Houston Headquarters." *(ibid.)*

It is our contention that the primary giver is requiring the chosen location to make it convenient for his/her employees. In place of building and staffing an onsite employee wellness center which would result in a 30 year depreciation tax write off, the firm is contributing to the YMCA, providing an employee benefit and in the process taking a one year charitable tax deduction. Such a contribution as shown in Issue #3 reduces the YMCA operational cost and reduces cost to employer should s/he pay ongoing dues for employees. Thus the contributor is receiving a form of private inurement due to their gift.

Issue # 10 Unfair competition a major concern of America's small business.

In the last two White House conferences on Small Business (1986 and 1994) unfair competition by tax exempt organizations was judged to be a major issue amongst small business. This proposal YMCA will constitute "unfair competition."

Issue # 11 Pontiac vs. Auburn Hills - where is the charitable need?

If the desire of the YMCA is to fill a public need or provide a public benefit then they should re-open the old Pontiac YMCA and leave the affluent market to be served by for-profit operators and public accessible facilities which already exist in the area of Auburn Hills.

The YMCA closed the Pontiac YMCA due to financial shortfalls, and as evidenced by the *Yes We Can* materials, now plans to locate in a part of town that can support the $6 million facility. This move is in direct conflict with the guidelines established in Smith vs. Reynolds, IRS collector 43 f. supp. 510.

> "A charitable institution is one established, maintained, and operated for the purpose of taking care of the sick, without any profit or view of profit, but a loss which has to be made up by benevolent contributions."

As stated above White House conferences on Small Business have established that "unfair tax exempt competition by non-profits" is one of the largest concerns facing businesses today. This obvious move by a non-profit into a market presently served by tax paying for profit businesses is an example of this growing problem.

1986 Statistical Abstract of the U.S.A.

No. 739. Characteristics and Annual Expenditures of Urban Consumer Units: 1982—1983

[Based on Consumer Expenditure Interview Survey; see text for description of survey. In interpreting the expenditure data, several factors should be considered. First, they are average for the total urban population. Second, expenditures reported here are direct out of pocket expenditures. Third, approximately 15 percent of expenditures are covered in the interview. Excluded are nonprescription drugs, household supplies and personal care items. The interview survey must be integrated with the Diary survey to provide a complete picture of expenditures.]

Item	Income before taxes [1]	Total expenditures	Food	Alcoholic beverages	Housing: Total	Housing: Shelter [2]	Housing: Fuel, utilities, and public service	Housing: Household operations	Housing: House furnishings	Apparel and services	Transportation: Gasoline and motor oil	Transportation: All other transportation [3]	Health care	Other expenditures [4]	Life insurance	Retirement, pension, social security	Personal taxes
All consumer units	$22,702	$18,892	$3,137	$285	$5,784	$3,262	$1,489	$271	$762	$1,030	$1,062	$2,649	$822	$2,498	$258	$1,367	$2,519
Complete income reporters	22,702	18,981	3,083	287	5,737	3,248	1,459	269	761	1,029	1,060	2,643	821	2,528	249	1,545	2,519
Quintiles of income																	
Lowest 20 percent	4,097	6,324	1,753	134	2,980	1,730	901	124	225	429	429	802	514	1,091	79	112	111
Second 20 percent	10,611	12,155	2,333	196	3,994	2,203	1,223	154	414	612	783	1,496	807	1,383	119	451	602
Third 20 percent	18,129	16,733	2,877	273	5,032	2,832	1,388	197	616	870	1,062	2,389	825	2,105	193	1,108	1,634
Fourth 20 percent	28,231	22,425	3,606	359	6,466	3,635	1,662	292	877	1,174	1,351	3,253	882	2,987	306	2,038	3,148
Highest 20 percent	52,267	35,171	4,834	468	10,188	5,824	2,116	578	1,669	2,054	1,692	5,257	1,074	5,055	546	4,002	7,076
Incomplete reporting of income	(NA)	16,334	3,482	274	6,078	3,353	1,677	280	767	1,037	1,073	2,696	826	2,307	311	248	(NA)
Age of householder																	
Under 25 years	11,537	11,617	1,835	343	3,410	2,151	668	115	475	782	745	1,878	307	1,594	64	659	1,256
25–34 years	23,835	19,271	2,949	356	6,409	3,915	1,305	359	831	1,071	1,073	2,979	547	2,163	205	1,519	2,913
35–44 years	29,718	24,296	4,046	322	7,494	4,411	1,789	327	968	1,428	1,308	3,450	753	3,285	353	1,855	3,263
45–54 years	31,198	24,716	4,166	307	6,870	3,658	1,969	226	1,016	1,366	1,493	3,497	936	3,612	434	2,035	4,130
55–64 years	24,450	19,497	3,328	260	5,374	2,697	1,701	208	767	993	1,145	2,511	1,056	2,676	324	1,830	2,585
65 years and over	13,583	12,348	2,288	133	4,123	2,073	1,342	267	440	515	603	1,370	1,228	1,686	154	247	844
Size of consumer unit																	
One-person	13,361	11,469	1,767	291	3,827	2,428	859	135	405	608	553	1,492	539	1,616	83	692	1,679
Two-person	23,423	19,377	3,025	303	5,909	3,280	1,521	229	879	992	1,036	2,816	1,023	2,534	293	1,446	2,664
Three-person	26,970	21,472	3,549	267	6,490	3,536	1,737	390	826	1,163	1,283	3,084	866	2,768	327	1,673	2,837
Four-person	30,992	24,956	4,232	278	7,575	4,191	1,930	443	1,010	1,473	1,465	3,426	858	3,227	384	1,942	3,306
Five-person	29,803	25,656	4,674	291	7,365	3,953	2,026	349	1,037	1,437	1,614	3,740	926	3,429	367	1,814	2,900
Six-persons or more	26,086	23,658	4,876	204	6,628	3,375	2,143	296	814	1,416	1,531	3,204	882	3,097	314	1,504	2,785
Region of residence																	
Northeast	21,704	18,038	3,234	301	5,677	3,173	1,590	228	687	1,002	913	2,447	756	2,352	203	1,151	2,023
Midwest	22,318	18,881	3,093	285	5,731	3,053	1,598	260	820	987	1,096	2,571	786	2,559	309	1,484	2,502
South	22,472	18,444	3,002	252	5,479	2,952	1,487	289	751	1,033	1,111	2,687	863	2,374	280	1,365	2,626
West	24,655	20,650	3,308	345	6,484	4,162	1,224	306	792	1,118	1,110	2,934	876	2,790	217	1,469	2,899

NA Not available. [1] Income values are derived from "complete income reporters" only. Represents the combined income earned by all consumer unit members 14 years or over during the 12 months preceding the interview. [2] Includes other maintenance and repair expenses not shown separately. [3] Includes other private transportation and public transportation. [4] Entertainment, personal care reading, education, tobacco and smoking supplies, cash contributions, and miscellaneous expenditures.

Source: U.S. Bureau of Labor Statistics, *Consumer Expenditure Survey: Interview Survey, 1982–83*, bulletin 2246, 1986.

Would include health club.

in lieu of: Average annual income expense of consumer units

'86

Appendix B

The Need For YMCA Construction

The YMCA of the USA has recommended an examination of the following four factors to justify construction and operation of a successful YMCA facility:

1. Strong demographics within a five mile radius.

Population. A recent national survey of YMCA membership indicated that 72.9% of Y members live within a five mile radius of a YMCA site (see map). Since user penetration in a given community is usually 4-7%, it is estimated that a minimum population of 75.000 (35,000 households) is required to sustain a YMCA. The five-mile radius population for the target site is presently at 164,863 (1990 census), and this figure is expected to increase by 11% per year through 1998. These population data strongly support construction at this site.

Household income to support programs. Household income is a critical ingredient since on-going YMCA operating costs will be offset by membership fees and program charges. The income profile of the target site strongly supports construction.

2. Adequate facility size to meet community needs.

The YMCA of the USA recommends construction of a facility of 60,000 square feet in size. Smaller facilities are not able to offer the scope of programming necessary to attract and retain sufficient membership. The YMCA Board of Directors has therefore targeted the facility size of at least 60,000 square feet.

3. Desire of the community for a YMCA.

An extensive feasibility study conducted by an independent consulting firm in 1994 verified that there is substantial individual and business support in the service area for the programs and service to be offered.

4. Adequate capital dollar support to construct a facility.

A 60,000 square foot facility can be expected to cost about $100 per square foot; thus, building construction will cost $ 6 million. Another $1.5 million will be required for furnishings, equipment, and offices. A suitable site has already been secured.

Less than 7% of population to be served (minus other competition).

It's Coming...

The New North Oakland Family YMCA

Population Shift...

continued from page 1

conditioning topped the list for the older group: those aged 18 to 34—who comprised the primary market for health club membership a decade ago—list feeling good afterward, increasing energy, and muscle tone as their top reasons for exercising.

The industry has been aware of the changing population mix, and has been offering more programs to appeal to the older member, i.e., weight control, stretching classes, and programs designed to reduce or eliminate impact on the body's joints (low impact aerobics, walking clubs, water exercise classes).

With basic health and functionality at the heart of the older member's concerns, clubs are increasingly partnering with health care providers and managed care organizations (MCOs) to incentivize more people to join health clubs as a means of maintaining their health.

"As the U.S. Surgeon General's Report on Exercise and Health (to be released in May 1996) will make clear, exercise is healthcare," said John McCarthy, executive director of IHRSA. "No one understands this better than the older exerciser."

The *IHRSA Trend Report*, sponsored by Cross Conditioning Systems, is published three times a year by

The International Health, Racquet & Sportsclub Association
263 Summer Street,
Boston, MA 02210
800-228-4772
617-951-0055
Fax 617-951-0056

Catherine M. McNeil, Editor

IHRSA is a non-profit trade association representing more than 2,700 health, racquet and sportsclubs in 45 countries

Top Ten States for Health Club Membership

According to the latest IHRSA/ASD Health Club Trend Report, 8.6% of the U.S population belongs to health clubs. Wyoming, with 15.6% of its residents as health club members, claims the number one spot for percentage of population having health club memberships. Below are the Top Ten (three-year average).

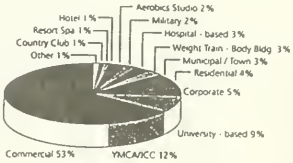
Rank	State	Number of Participants	Participants Per 100 People
1	Wyoming	96,000	15.6
2	Washington	815,000	12.8
3	Georgia	668,000	12.3
4	California	2,892,000	12.3
5	Maryland	666,000	10.5
6	Nevada	69,000	10.4
7	Massachusetts	486,000	10.0
8	Delaware	114,000	9.4
9	Colorado	341,000	9.0
10	New Jersey	519,000	8.7

Where People Exercise

When looking for a place to work out, one out of two people will choose a commercial health club over other options, according to the IHRSA study, *Why and Where People Exercise*.

Type of Health Club Membership

Repercentaged to account for multiple responses



Kids...

continued from page 1

- getting close with friends
- meeting new people
- making new friends
- becoming popular
- learning new things
- not being bored
- getting a break from responsibilities

One surprising—and welcome—finding was that girls are interested in lifting weights, primarily because it tones the body and improves appearance. They said that they would like to see advertisements showing teenage girls lifting weights. While their interest in strength training may only be skin-deep, the benefits they receive from the activity will cut right to the bone. Research has found that weight-bearing exercise delays bone loss and promotes bone formation in girls most at risk of osteoporosis.

Only a small portion of the 8.6% will join the YMCA.

Appendix D

Site Selection

An analysis of several sites within our service area was undertaken as part of a financial feasibility study conducted in 1994. Forty-six interviewees were challenged to suggest a suitable site that could attract major philanthropic support and provide reasonable transportation accessibility. Four criteria (with percentage weights for each) were used in scoring for each site.

These criteria are:

- **Proximity** to high density population target area (10%).
- **Convenience** for users to drive to the site easily (10%).
- **Philanthropy** available to support a specific site location (60%).
- **Probability** of securing lease for specific site in question (20%).

Discussion:

The weighted-score approach allowed us to adjust the relative importance of each of the four criteria. Thus, for each site location, the decision score was based 10% on proximity and convenience, 20% on the probability of obtaining a lease for the land, and 60% on the strength of philanthropic support for a facility at a particular site. **After consideration of all the locations and criteria, the City of Auburn Hills site was the clear front-runner. This is the site upon which the YMCA will be constructed.**

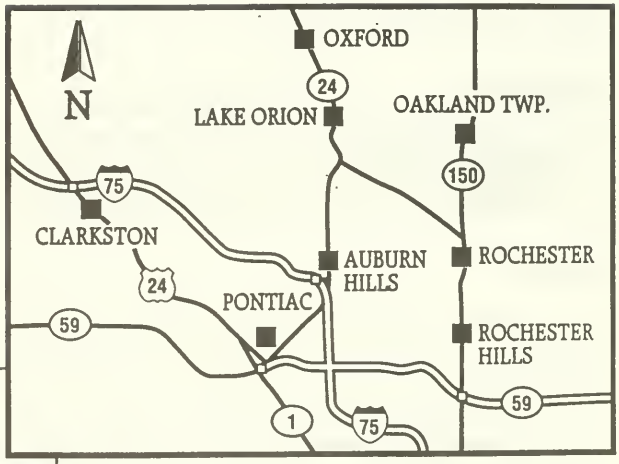
Nowhere in site selection was the criteria of "Community Cross-Section" used to make this decision.

It's Coming...

The New North Oakland Family YMCA

Appendix E

YMCA



OAKLAND COUNTY

Existing facility closed 5 miles from proposed site.

It's Coming...

The New North Oakland Family YMCA

Wed Feb 2, 1994

Appendix F

CUSTOM SUMMARY REPORT
(POP FACTS: PROFILE REPORT)
BY NATIONAL DECISION SYSTEMS 619-942-7000

_JIRREL/FEATHERSTONE

		SITE:	
	COORD:	42.6501	83.2202
DESCRIPTION		5.00 MILE RADIUS	10.00 MILE RADIUS
POPULATION			
1998 PROJECTION		182,982	579,170
1993 ESTIMATE		173,723	565,907
1990 CENSUS		164,863	551,216
1980 CENSUS		145,063	520,782
GROWTH 80 - 93		19.76%	8.66%
HOUSEHOLDS			
1998 PROJECTION		68,905	235,442
1993 ESTIMATE		64,500	217,550
1990 CENSUS		59,162	204,566
1980 CENSUS		48,653	178,948
GROWTH 80 - 93		32.57%	21.57%
POP. BY RACE & SPANISH ORIGIN		164,863	551,216
WHITE		75.68%	88.94%
BLACK		18.70%	6.82%
AMERICAN INDIAN		0.46%	0.35%
ASIAN & PACIFIC ISLANDER		3.18%	3.03%
OTHER RACES		1.98%	0.86%
SPANISH ORIGIN - NEW CATEGORY		4.15%	2.31%
OCCUPIED UNITS		59,162	204,566
OWNER OCCUPIED		65.91%	73.35%
RENTER OCCUPIED		34.09%	26.65%
1990 PERSONS PER HH		2.79	2.69
YEAR ROUND UNITS IN STRUCTURE		63,097	215,000
1 ATTACHED		7.80%	5.16%
1 DETACHED		61.38%	68.92%
2 TO 9 UNITS		14.94%	11.71%
10+ UNITS		11.60%	10.63%
MOBILE HOME OR TRAILER		3.32%	2.93%
UNIT OTHER		0.96%	0.65%
SINGLE/MULT UNIT RATIO		2.61	3.32
1993 EST. HOUSEHOLDS BY INCOME		64,500	217,550
$150,000 OR MORE		4.25%	5.33%
$100,000 TO $149,999		11.27%	11.59%
$ 75,000 TO $ 99,999	61%	12.23%	12.98%
$ 50,000 TO $ 74,999		18.79%	22.84%
$ 35,000 TO $ 49,999		14.27%	16.14%
$ 25,000 TO $ 34,999		10.65%	10.65%
$ 15,000 TO $ 24,999		10.26%	9.15%
UNDER $15,000		18.28%	11.32%

North Oakland County YMCA Capital Development Plan

Appendix G

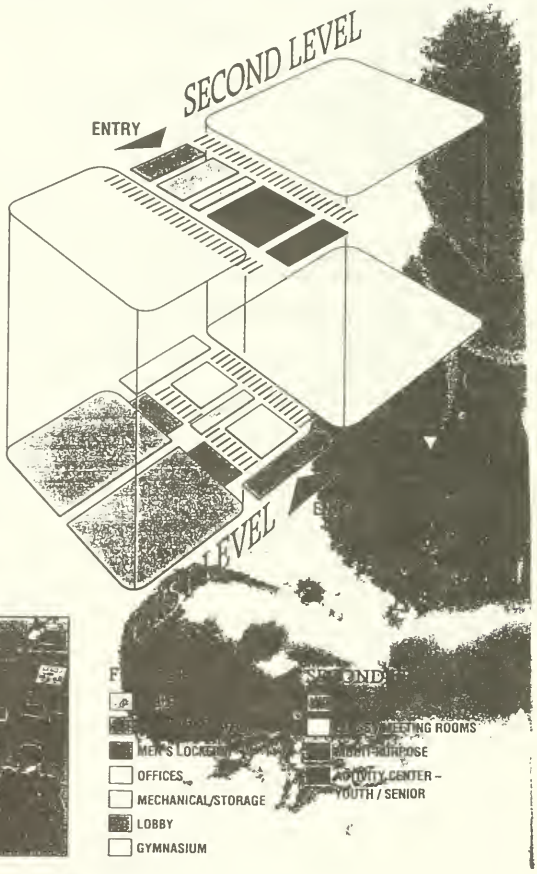
The North Oakland County YMCA is an organization that serves over 4,000 people. They all share a common interest in promoting strong family relationships, healthy minds and bodies and service to the community. The YMCA currently coordinates all of its programs out of a small rented office in Rochester. Over the past several years demand for programs has exceeded the rental space available in local recreational facilities. The Board of Directors and staff have determined that a full service YMCA facility is needed to best serve the communities of North Oakland County.

Q What type of facility do you envision?

A
- Aquatic facility.
- Multi-purpose, recreational and educational.
- Possible phased construction.
- Adaptable to changing needs of community – 100% accessible by all persons.

Q Why doesn't the YMCA just continue to rent facilities?

A
- Prohibitive cost increases and inconsistent availability
- Scarcity of adequate pool facilities in this community, particularly for youths, seniors, and people with special needs.
- There are no facilities in the area that meet the American Disabilities Act.
- Increasing competition for availability of existing facilities expected to increase in the future due to growth and expansion within our service area.



Appendix H

Making An Investment In The YMCA

• • •

This prospectus describes a project to design, build and equip a comprehensive 60,000 square foot YMCA facility. The purpose of this document is to propose an outstanding community investment opportunity for your consideration. During the past eighteen months, the North Oakland County Family YMCA Board of Directors has carefully studied the need for construction of a full facility YMCA to serve the communities of Addison, Auburn Hills, Clarkston, Lake Orion, Oakland, Oxford, Pontiac, Rochester, Rochester Hills, and Waterford. The Y Board has determined that demand for its expanded services is strong. Our analysis shows that there is no similar facility offering programming of this nature in the service area. Further, no suitable buildings exist at desirable site locations.

The YMCA Board has negotiated a 99 year lease agreement for use of land owned by the City of Auburn Hills. Further, a unique public-private partnership has been formed in which the function of the entire City of Auburn Hills Recreation and Senior Center departments will be assumed by the YMCA.

A major capital campaign program, headquartered at the Comerica building in Auburn Hills, has been undertaken to secure financial pledges and contributions. The campaign goal is 7.5 million dollars. A 60,000 square foot facility will be constructed for 6 million dollars on the land already secured; equipment, furnishings and infrastrucure will cost 1.5 million dollars. A major corporate contribution of 1.5 million dollars has already been secured in support of the financial objective.

In the next few pages, you will learn the details of this exciting project.

• • •

YMCA

It's Coming...

The New North Oakland Family YMCA

Appendix I

North Oakland County YMCA

EXECUTIVE SUMMARY

This report presents the methods and findings of a feasibility study conducted to investigate the potential for constructing a full-facility YMCA to serve North Oakland County. The number-one site recommendation is to proceed with negotiations to lease land located behind the City of Auburn Hills offices. Community leaders interviewed strongly favored this site relative to the other six sites investigated. We found the potential for a lead gift that will cover a minimum of 30-35% of the total project cost, if the project is constructed at this site. Through a capital campaign and concomitant marketing information program, additional philanthropic support will be available to fund construction. A full set of recommendations and next steps is offered for YMCA Board consideration.

Appendix J

When is Recreation 501(c)3?

by A. S. Garrett

Background:

US Tax Court Cases - **Recreational**

US Tax Court has addressed recreational facilities in 6 cases in the past 43 years. All cases demonstrated that recreation in and of itself is not tax-exempt 501(c)3.

- 1987 - Columbia Park vs. Comm. 88 TC 1

Found that a non-profit recreational entity which served Columbia Park was 501(c)4, not 501(c)3.

- 1981 - Schoger Foundation vs. Comm 76 TC 380

Found that religious camps which offer recreation were not 501(c)3:

> "not operated for any of the purposes specified within the meaning of 501(c)3 since you are operated primarily to provide members of the public with social and recreational activities in a commercial manner."

- 1975 - Eden Hall Farm vs, U.S. 389 Sup. 858.

Found a non-profit vacation home for working women to receive rest and recreation was not 501(c)3 but was granted 501(c)4 status.

- 1963 - People's Educational Camp vs. Comm. 331 f.2d. 923

A non-profit resort camp was denied 501(c)4 based on the fact that it

> "competes actively for the public business with other commercial resorts in the Poconos area."

- 1955 - Estate of Philip Thayer vs. Comm. 24 TC 384

Found a California Alumni Association camp was 501(c)3:

> "The cause of the issue is whether the social and recreational activities are "substantial" or merely incidental to the objective of advancing interests of the university."

Recreation was judged to be 501(c) 3 because it was incidental in size and purpose.

- 1953 - Isabele Peters vs. Comm. 21 TC 55

Found that a public beach provided at no charge to all residents of Cold Springs Harbor was 501(c)3. Determining factors: built primarily for those who could not afford to belong to a private beach; no admission fee was charged; donations were not required for use.

It is our belief that anything given for free (food, toys, medical attention etc.) would pass a charitable/social welfare test due to the means in which it was given, ie. free.

US Tax Court Cases - **Social**

• 1993 - Spanish American vs. Comm.
Found that a non-profit organization which wanted to build a community center to be used by all residents of the community for a small fee was judged not to be 501(c)3 but granted 501(c)4.

Congressional Action on Recreation

When the tax code was created, Congress recognized the existence of recreation and placed it into two separate categories:

• 501(c)4 - Promotion of community welfare, charitable, educational or recreational. IRS Publication 557 July 1985.

Conditions for qualification:

a) must be non-profit
b) further a common good and general welfare of the people of the community.
c) cannot be restricted just to employees or members.

Examples: Rev. Rul. 67-109, 69-384, 70-4, 80-215

• 501(c)7 - Social and Recreational Clubs - promote pleasure, recreation and social activities.

Conditions for qualification:

a) cannot discriminate
b) cannot provide private inurement
c) members must be bound together for social, recreation or other non-profitable purposes.
d) membership must not be limited.
e) must be solely supported by fees, dues and assessments.
f) only 15% of income may be derived from guest fees.

Examples: Rev. Rul. 94-1318, 69-636, 58-589

Summation:

Both Congress and the US Tax Court have established that recreational facilities in and of themselves are not 501(c)3 unless they are insignificant to a larger bonafide 501(c)3 exempt purpose or unless they are provided for free to an unrestricted public.

Appendix K

In 1995 an Auburn Hills, MI City Council meeting was held, with Item 11A covering the topic of a proposed partnership between the City of Auburn Hills and the YMCA of North Oakland County. The following are excerpts taken from the enclosed video tape of that meeting.

Joseph Moceri, president of the N. Oakland YMCA introduced Larry Scramlin, the executive director of the same YMCA then proceeded to outline the proposed facility. Afterwards the meeting was opened to the public for questions. Shelly Sanders (SS), executive director of the Great Lakes Management Association had the following exchange with Joseph Moceri (JM), Larry Scramlin (LS) and a City Council member (CC):

SS: If money is raised through fundraising will this money be tax deductible?
LS: Yes.
SS: It's my understanding that the YMCA has to file for a 501(c)3 exemption. Is that true and has that been done?
LS: Yes it is true for the YMCA. No, it has not been done for this facility.
SS: What percentage of the YMCA will be used for recreational programs?
LS: How do you define recreational programs?
SS: Any organized activities.
JM: I would say basically, 100%.
CC: Your overall theme is recreational, is what you're saying?
JM: Yes.

Letters are sent by Certified Mail.

P 530 844 930

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Receipt for Certified Mail
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Return Receipt Showing to Whom & Date Delivered	
Return Receipt Showing to Whom, Date, & Addressee's Address	
TOTAL Postage & Fees	2.52
Postmark or Date	

PS Form 3800, April 1995

POSTMARK 1996 USPS

Date:

Employer Identification Number:

Contact Person:

Contact Telephone Number:

Example of IRS letter

Accounting Period Ending:
August 31
Form 990 Required:
Yes
Caveat Applies:
No

Dear Applicant,

Based on information supplied, and assuming your operations will be as stated in your application for recognition of exemption, we have determined you are exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code.

We have further determined that you are not a private foundation within the meaning of section 509(a) of the Code, because you are an organization described in sections 509(a)(1) and 170(b)(1)(A)(vi).

If your sources of support, or your purposes, character, or method of operation change, please let us know so we can consider the effect of the change on your exempt status and foundation status. In the case of an amendment to your organizational document or bylaws, please send us a copy of the amended document or bylaws. Also, you should inform us of all changes in your name or address.

As of January 1, 1984, you are liable for taxes under the Federal Insurance Contributions Act (social security taxes) on remuneration of $100 or more you pay to each of your employees during a calendar year. You are not liable for the tax imposed under the Federal Unemployment Tax Act (FUTA).

Since you are not a private foundation, you are not subject to the excise taxes under Chapter 42 of the Code. However, you are not automatically exempt from other Federal excise taxes. If you have any questions about excise, employment, or other Federal taxes, please let us know.

Donors may deduct contributions to you as provided in section 170 of the Code. Bequests, legacies, devises, transfers, or gifts to you or for your use are deductible for Federal estate and gift tax purposes if they meet the

applicable provisions of Code sections 2055, 2106, and 2522.

The heading of this letter indicates whether you must file Form 990, Return of Organization Exempt from Income Tax. If Yes is indicated, you are required to file Form 990 only if your gross receipts each year are normally more than $25,000. If a return is required, it must be filed by the 15th day of the fifth month after the end of your annual accounting period. The law imposes a penalty of $10 a day, up to a maximum of $5,000, when a return is filed late, unless there is reasonable cause for the delay.

You are not required to file Federal income tax returns unless you are subject to the tax on unrelated business income under section 511 of the Code. If you are subject to this tax, you must file an income tax return on Form 990-T, Exempt Organization Business Income Tax Return. In this letter, we are not determining whether any of your present or proposed activities are unrelated trade or business as defined in section 513 of the Code.

You need an employer identification number even if you have no employees. If an employer identification number was not entered on your application, a number will be assigned to you and you will be advised of it. Please use that number on all returns you file and in all correspondence with the Internal Revenue Service.

If the heading of this letter indicates that a caveat applies, the caveat below or on the enclosure is an integral part of this letter.

Because this letter could help resolve any questions about your exempt status and foundation status, you should keep it in your permanent records.

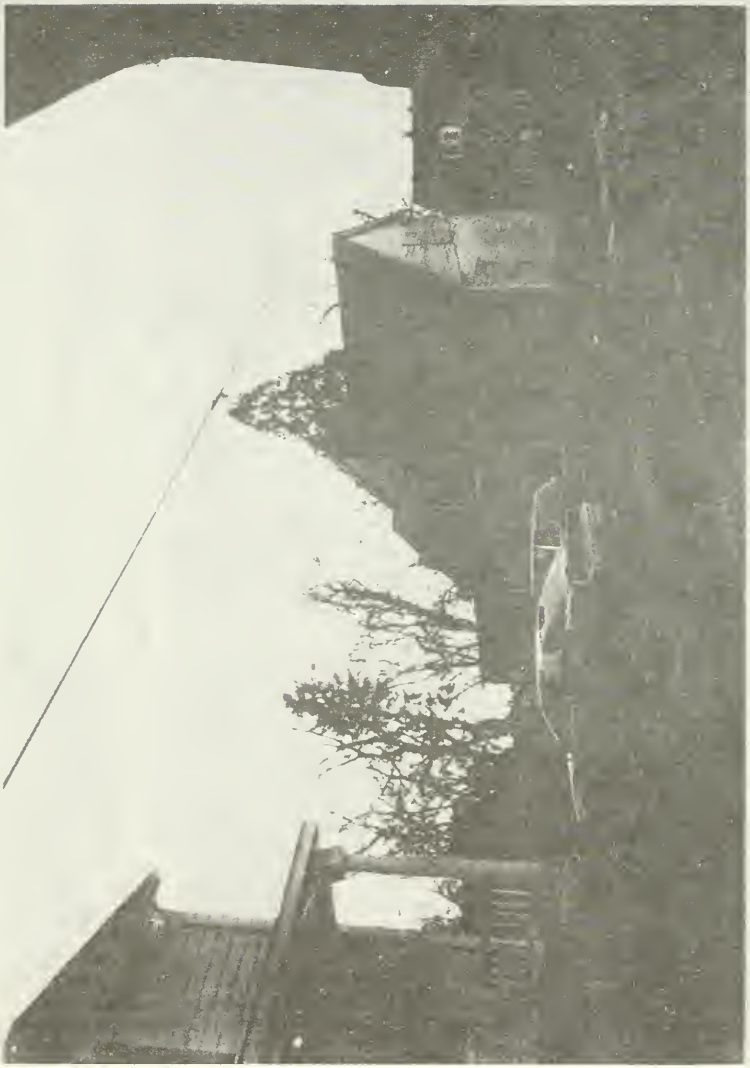
If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

District Director

Letter 947(DO/CG)

The recently closed Pontiac [illegible]



Residential area served by recent used [illegible]

August 2, 1996

The Honorable Jan Meyers
Committee on Small Business
US House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

aerobics
basketball
childcare
martial arts
massage
nutrition
raquetball
spa
tanning
volleyball
weights

Dear Madame Chairman:

I am writing to personally request that the official record of hearings for the House of Representatives' Committee on Small Business, held on July 16 and 18, be submitted to the House Small Business Committee for its official record regarding the unfair competition hearings.

As a small, independent, fitness center owner, I must compete with an existing YMCA and the prospect of a community, city-owned recreation center in Rapid City, a town of approximately 55,000 people. Both of these entities duplicate the facilities and services offered at my and two other for-profit clubs in the area. The unleveled playing field in which these non-profit centers operate make it a continual, financial challenge to exist in the community. Loss of revenue, movement of members, as well as a continual drain of time and money to compete with these non-profit centers, make it very difficult for the small business owner to survive in this lopsided environment.

Please help protect small businesses from unfair competitors such as the YMCA and City-planned Recreation Centers. I would recommend the following:

1. Require the US Treasury to provide a public estimate of revenues lost through nonprofits' avoidance of Unrelated Business Income Tax.
2. Congress should authorized the GAO to undertake a study to determine the extent to which nonprofit health and fitness centers actually serve needy individuals and charitable classes.
3. The Small Business Committee should call on their colleagues in Congress to clarify the tax laws governing commercial activities by tax-exempt organizations.

4020 Jackson Blvd Rapid City, South Dakota 57702 T 605 348 5858 F 605 341 2977

Small fitness related businesses appreciate your efforts to ensure their survivability. Thanks for your interest in addressing their concerns.

Sincerely,

Tracy L. Settle, Owner

Sta-Fit
RACQUET & ATHLETIC CLUBS

SOUTH
5501 South Regal
Spokane, WA 99223
(509) 448-8442

EAST
14210 East Sprague
Spokane, WA 99216
(509) 926-1241

NORTH
8707 North Division
Spokane, WA 99218
(509) 467-1500

DOWNTOWN
718 West Riverside
Spokane, WA 99201
(509) 747-2500

POST FALLS
527 East Seltice Way
Post Falls, ID 83854
(208) 777-8080

COEUR D'ALENE
208 Coeur d'Alene Ave
Coeur d Alene, ID 83814
(208) 667-5010

LEWISTON
621 Bryden Avenue
Suite G
Lewiston, ID 83501
(208) 798-8888

HEALTHY HEART CAFE
718 W Riverside
Spokane, WA 99201
(509) 747-0777

SPA PARADISO
601 W Riverside
Spokane, WA 99201
(509) 747-3529

August 2, 1996

The Honorable Jan Meyers
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Madame Chairman:

I request this letter be submitted to the House Small Business Committee for its official record. This letter is in regards to the unfair competition hearings held in July.

The local YMCA near our facility located in downtown Spokane offers the same facilities, actually more, than we offer at a lower monthly fee. Their single person monthly fee (offered to the public) is $33 per month compared to ours at $42.95. A family fee is $48 per month compared to our fee at $52.95. The YMCA has two pools and two gymnasiums included in their monthly fee. We do not have these facilities downtown. I assure you our monthly fee is not higher than necessary to cover our operating costs.

Several personnel in our organization have made inquiries as to the monthly fee and facilities offered by the YMCA. Not once, in any of these inquiries, were they asked their income level.

It does not appear the not-for-profits are merely serving the underprivileged as they were initially set up to do, in this example. The YMCA is competing for the same customers and dollars as we are.

I guess that explains why they have three times as many members downtown as we do.

Currently, there are plans to develop another, even larger YMCA in Spokane's Valley. This will enable them to compete with the tax paying fitness centers on an even larger scale.

This is a formal request. I am asking Congress to address this issue. Myself, as well as other small business', need protection from unfair competition from not-for-profits.

It is difficult to compete with these not-for-profits. They are able to offer lower rates for the same facilities due to less overhead and operating costs from the unfair breaks they receive. We can't compete!

CORPORATE OFFICE
5505 S. REGAL ST. • SPOKANE, WA 99223-9950 • (509) 448-2151 • 1-800-782-3487 • FAX (509) 448-2032

INDOOR TENNIS • INDOOR POOL • RACQUETBALL • AEROBIC DANCE • FITNESS CENTER • SAUNA/JACUZZI • ATTENDED NURSERY

I recommend the U.S. Treasury provide to the public an estimate of revenues lost through tax breaks allowed to nonprofits through the Unrelated Business Income Tax. These revenues, if collected, could even help balance our budget.

I would also like to see Congress authorize the General Accounting office to study the extent to which nonprofit health and fitness centers actually serve needy individual and charitable classes.

I also request the Small Business Committee ask their colleagues in Congress to clarify the tax laws governing commercial activities by tax-exempt organizations.

I feel all of this is necessary to remedy the unfair competition in the health and fitness industry.

Respectfully yours,

Scott Sherman
General Manager

SS/mw

The Honorable Jan Meyers
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC. 20515 8/1/96

Dear Madame Chairman,
I would like to request that this letter be submitted to the House Small Business Committee for its official record regarding the unfair competition hearings held in July.
I'm writing you this letter as a businessman that directly competes (unfairly) with a non-profit organization, specifically the YMCA. As I write you this letter the local YMCA is planning the grand opening of there new "state of the art" wellness center. This center is identical in almost every aspect (except they only have to charge 1/3 as much for membership) as the commercial club I own. The YMCA actually had there architects tour our club to get design ideas! The YMCA aggressively markets and advertises this facility to both area residents and corporations, they even go as far as to offer corporations special reduced pricing for groups of five or more people! This is absolutely outrageous, the only reason they are able to do this is that they do not pay any taxes (not to mention the breaks they get on postage and other services) which gives them an unfair advantage over our tax paying club. They collect there dues the same way as we due through electronic funds transfer, **there members are not making monthly donations**, they are paying for a service. Further the location of the YMCA is in one of the most affluent areas of the state, not in an area that needs charitable help. The YMCA will argue that the money they generate goes to a needy cause, but this argument has no merit. If all you have to do is donate some money to a needy cause, then all of the fortune 500 and most businesses should be tax exempt. The YMCA and other non-profit organization are abusing our system by operating commercial money making businesses and paying no taxes! The local YMCA has hurt my business and with there new wellness center will be more difficult to compete with.

I would like you to consider the following:

- Ask congress to address the issue and provide small businesses with protection from unfair competition from non-profit organizations.
- The US Treasury department should be required to provide a public estimate of revenues lost through non-profit organizations avoidance of Unrelated Business Income Tax (UBIT).
- Congress should authorize the General Accounting Office (GAO) to undertake a study to determine the extent to which non-profit health and fitness centers actually serve needy individuals and charitable classes.

3005 W. Lake Mary Boulevard, Suite 124 • Lake Mary, Florida 32746 • Phone: (407) 322-2511 • Fax (407) 322-2403

- The Small Business Committee should call on their colleagues in Congress to clarify the laws governing commercial activities by tax-exempt organizations.

In closing I would like to say that it is no wonder so many organizations have and are applying for non-profit status given the enormous competitive advantage and benefits it provides. If things don't change, soon I may just as well apply myself!

Yours in good health,

Wayne Steidle
President

QUIVIRA SPORTS & HEALTH
A QUALITY HEALTH AND FITNESS FACILITY

7880 Quivira, Lenexa, KS 66216 913.268.3633 Fax: 913.268.3311

The Honorable Jan Meyers
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Madame Chairman:

Please submit this letter to the House Small Business Committee for its official record regarding the unfair competition hearing held July 16 & 18.

Non-Profit organizations are competing directly for membership against our for profit health/fitness facilities. As one example, Quivira Sports & Health will be involved in a local event, called Prime Expo designed to introduce the older adults to many companies and organizations on November 9, 1996. The other health/fitness organization attending Prime Expo this year is the YMCA. They are competing directly against us for the Senior Market in this area, but because of there status as a Non-Profit organization has a large financial advantage.

Please provide small business with protection from unfair competition from non-profit. I would recommend:

a. The U.S. Treasury Department should be required to provide a public estimate of revenues lost through non-profits' avoidance of Unrelated Business Income Tax.
b. Congress should authorize the General Accounting Office to undertake a study to determine the extend to which nonprofit health and fitness centers actually serve needy individuals and charitable classes.
c. The Small Business Committee should call on their colleagues in Congress to clarity the tax laws governing commercial activities by tax-exempt organizations.

Best in Health
Quivira Sports & Health

Dean Weishaar
Director of Wellness Services

cc: Hal Edwards, Club Owner
Jay Ablondi, IHRSA

COMMITTEE FOR PURCHASE FROM
PEOPLE WHO ARE BLIND OR SEVERELY DISABLED

703-603-7740
FAX 703-412-7113

Crystal Square 3, Suite 403
1735 Jefferson Davis Highway
Arlington, Virginia 22202-3461

August 8, 1996

Representative Jan Meyers
Chair, Committee on Small Business
U.S. House of Representatives
Rayburn House Office Building, Room 2361
Washington, DC 20515-6315

Dear Representative Meyers:

The purpose of this letter is to submit comments in response to testimony on the Javits-Wagner-O'Day (JWOD) Program that was presented to your Committee on July 18, 1996. During that hearing on "Unfair Government-Supported Competition with Small Business," four witnesses criticized the JWOD Program and the Committee for Purchase From People Who Are Blind or Severely Disabled, the independent Federal agency which oversees its implementation.

I am writing in my capacity as Executive Director of the Committee, a career Senior Executive post I have held for the past eight years. Although other representatives of the JWOD team are writing with respect to some of the statements made at your hearing, we felt it was appropriate that you hear directly from the Committee.

Let me begin by explaining that the purpose of the JWOD Program is to use Federal procurements to generate employment and training opportunities for individuals who are blind or have other severe disabilities. It is a jobs program targeted at a population with an unemployment rate that far exceeds that of any other segment of our society. The Committee determines which products and services required by Federal customers should be provided by nonprofit organizations employing people with severe disabilities. It places suitable products and services on its Procurement List, which means that Federal employees are then required to purchase such items from the nonprofit agencies designated by the Committee. In addition, the Committee establishes fair market prices for the products and services on its Procurement List.

To assist in carrying out its duties, the Committee, whose members serve on a part-time basis, employs a full-time staff of 18 career civil servants. While only the Committee decides which products and services can be added to the JWOD Program, it has delegated numerous functions to the staff, which performs them in accordance with established policies and procedures. In addition, the Committee has designated two national nonprofit organizations--National Industries for the Blind (NIB) and NISH--to help State and private nonprofit agencies participate in the JWOD Program and to furnish data to the Committee. While NIB and NISH have no decision-making

responsibilities under the JWOD Program, their contributions are essential to its successful implementation. The Committee receives an appropriation to cover its direct expenses, and oversees an approach approved by Congress to provide operating resources for NIB and NISH.

Having described the structure of the JWOD Program, I will now turn to those comments by your witnesses which we believe should be addressed in the official hearing record. The first point involves the Committee's consideration of firms that are current contractors for products and services proposed for addition to the JWOD Program. The testimony you heard suggested that the Committee is not interested in receiving comments from such firms and, when they are received, dismisses them summarily. In addition, it was alleged that NISH is inappropriately involved in deciding whether a proposed addition would have a severe adverse impact on the current contractor, a key determination in the Committee's decision-making process.

These charges are without foundation. As noted above, neither NIB nor NISH has any decision-making power in the JWOD Program; only the Committee decides whether a potential action might cause severe adverse impact on the current contractor. Moreover, the principals of both firms testifying before you have been given ample opportunity to bring concerns to the Committee's attention and, in each case, have them addressed. The fact that the Committee did not agree with the firms' contentions about the potential effect of its actions or approve their alternative proposals does not support the conclusion that it did not consider all the facts and figures brought to its attention. In one of the cases cited, the Committee has devoted a tremendous amount of time and resources to considering the issues that have been raised and has not yet made a decision. Nonetheless, it is accused of "ignoring the law" and of perhaps preparing to punish the contractor because it appealed to members of Congress.

Congress understood in enacting the JWOD legislation that the Committee could not achieve its mission without having some impact on private, profit-making businesses. The courts have also recognized that such impact was inherent in operating the JWOD Program. The question is what level of impact is permissible. In this regard, the Committee has always considered the percentage of a contractor's total sales represented by the item proposed for addition to the JWOD Program, as well as all other relevant information submitted by any source. Moreover, as the enclosed study of the impact of the JWOD Program on small businesses reports, there is no evidence that Committee actions have severely impacted current contractors for items added to the Procurement List. This finding suggests that the approach employed by the Committee works well.

It is also appropriate to point out that, when feasible, the Committee has occasionally agreed to some unusual step to minimize what it has determined to be an acceptable level of impact. One of the contractors appearing before you was the beneficiary of

26-158 96 – 19

such an action. In that case, the firm was permitted to continue to compete to supply the Government with some of the products involved for an additional year to use up its inventory and adjust to the loss of future business opportunities. For the record, we note that the sales of both contractors appearing before you have risen since the Committee added items they were making to the JWOD Program.

Other "facts" presented by the contractors who appeared before you do not hold up to scrutiny. For example, the charge that a nonprofit agency is purchasing stencils from the contractor and selling them to the Government at a markup is simply not true. The organization in question has assured the Committee that it has purchased no stencils from the contractor. Similarly, data on the percentage of wages going to people with severe disabilities in conjunction with the JWOD contracts for interment flags is presented as fact, when it is based (at best) on erroneous assumptions by the contractor.

A related accusation that "less than 10 to 15 percent of the labor required for most JWOD contracts is actually done by disabled workers" also has no basis in fact. Neither the Committee nor any other source collects specific data on indirect labor associated with providing a JWOD product or service is performed by people with severe disabilities. The Committee collects data only on direct labor hours, since that is the work Congress targeted for people with severe disabilities and represents the most labor intensive aspect of manufacturing and service operations. In FY 1995, 77.46 percent of the direct labor hours worked on JWOD contracts was performed by people with severe disabilities.

Your witness would have Congress believe that the 77.46 percent means little because nonprofit agencies subcontract much of the direct labor required to provide a JWOD product or service and the subcontracted work is not performed by people with severe disabilities. Again, the witness misleads. The organizations participating in the JWOD Program are in the business of providing employment and training for people with severe disabilities. Consequently, it is in their interest to have as much labor as possible performed by such individuals. For this reason, in the overwhelming majority of JWOD contracts, the total amount of direct labor required to make the product or furnish the service is performed by the nonprofit agency involved. It is not contracted out to private profit-making firms. The nuclear aircraft carrier example cited by your witness as defying "all logic" would not only never be approved by the Committee, but would never be proposed by a nonprofit agency.

Before turning to the remarks of the witnesses from the disability community, I must address another of the other criticisms levelled by one of the Federal contractors appearing before you. Suggesting that JWOD was trying to put him "out of business," the contractor charged that the program was "riddled with conflicts of interest" and had no "oversight" or "accountability." The conflict of interest allegation appears to stem

from the erroneous conclusion that NISH has some decision-making authority. While less easily explained, the other charges may derive from a perception that because the Committee is an independent agency, neither the Administration nor Congress tracks its operations. Obviously, this is not the case, as both the Office of Management and Budget and our Congressional Appropriations Subcommittees review the Committee's activities every year. In addition, the Committee submits an Annual Report describing its accomplishments to each member of Congress. The JWOD Program was also examined as part of the Clinton Administration's National Performance Review, which reaffirmed its value to both people with severe disabilities and Federal customers.

These facts alone refute your witness's contention. But there is more: the structure of the Committee in and of itself assures an extraordinary degree of oversight and accountability. Unlike most Federal agencies, the Committee is composed of representatives of eleven other Federal Departments, as well as four private citizens with responsibility for assuring that the needs of people who are blind or have other severe disabilities are considered. Included among the Federal Department representatives are contracting officials who have a vested interest in protecting their agencies' customers from inappropriate decisions by the full Committee. It would be difficult to imagine more vigilant watchdogs.

In addition to hearing from contractors affected by the JWOD Program, you received testimony from two representatives of the disability community. Both questioned the continued relevance of the JWOD Program in the 1990's, contending in effect that it had outlived its usefulness. In addition, they characterized the hundreds of nonprofit agencies that participate in the JWOD Program as treating people with disabilities as "helpless patients," who are "happier" with their "own kind." They also portrayed the jobs provided by such organizations as "simple, menial, underpaid," with one alleging that the positions pay "an average of .25 (sic) per hour."

Consensus is no easier to achieve in the disability community than in any other diverse group. While the prevailing school of thought is that people with disabilities (including those with severe disabilities) should have the freedom to choose from a range of vocational options, there are those who are convinced that the only option should be a job with a "mainstream" employer. This group, which apparently includes the two individuals who testified before you, rejects the types of jobs created through the JWOD Program because of the nature of the employer involved. Their opposition exists despite an unemployment rate for people with disabilities that continues--even with the 1990 enactment of the Americans with Disabilities Act--to exceed 65 percent. Regrettably, the persons who appeared before you advanced the stereotypical negative portrait of the types of organizations which employ people with disabilities and, in so doing, mischaracterized both the nonprofit agencies participating in the JWOD Program and the jobs they provide, as well as misstated facts.

For the record, you should be aware that the "helpless patient, happier with their own kind" mentality is not representative of the leadership of the Committee, NIB, NISH, or the hundreds of nonprofit agencies that participate in the JWOD Program. To the contrary, these organizations are dedicated to helping people with severe disabilities achieve their maximum potentials and live as independently as possible. The wide range of services (including job placement assistance) and employment options (including supported work with "mainstream" employers) offered by the majority of the JWOD-participating nonprofit agencies testifies to this commitment.

I must also take exception to the comments about the types of jobs and wages paid by the nonprofit agencies that participate in the JWOD Program. JWOD jobs vary in their degree of technical complexity. To accommodate the varying abilities of the people with severe disabilities who perform the jobs, nonprofit agencies simplify work stations as necessary to ensure productive outcomes. (In this regard, it should be noted that, according to a 1991 survey, approximately half of the individuals with JWOD jobs have more than one disability and a similar percentage are mentally retarded.) What is important is whether the jobs are consistent with the skill levels and interests of the people who perform them. An individual with a severe disability can then exercise his or her right to choose a JWOD job as a preferred training and employment option. A Mississippi State University survey of individuals who are blind as well as interviews by Committee staff with hundreds of individuals who are blind or have other severe disabilities provide strong evidence that most of them are quite satisfied--and often thrilled--with their JWOD jobs.

A final area in which your witnesses erred involves the wages paid to people with severe disabilities under the JWOD Program. The "25 cent per hour" average wage alleged bears no resemblance to the actual average wage of $6.11 per hour during FY 1995, a figure that does not in all cases include the benefits received by the workers. Far from being "underpaid," JWOD contract employees receive wages derived from Federal statutes that are designed to protect all workers from unscrupulous employers. As a result, nonprofit agencies in the JWOD Program tend to err on the side of paying too much rather than too little. I would submit that it is not the JWOD Program that is out of date, but rather your witnesses, who appear to have little knowledge of today's JWOD jobs or the organizations through which those jobs are provided.

In closing, let me express my appreciation for the opportunity to submit a response to the testimony presented at your hearing. If you pursue any JWOD-related issues in the

future, we would be happy to present more information on what those of us associated with it are convinced remains a viable program, providing excellent employment options for many people with severe disabilities.

Sincerely,

Beverly L. Milkman
Executive Director

Enclosure

Javits–Wagner–O'Day

JWOD

The JWOD Program: An Assessment of its Impact on Small Businesses

Rebecca L. Smith, Ph.D.
Associate Director for Research
Committee for Purchase From People Who Are Blind or Severely Disabled

June 10, 1996

COMMITTEE FOR PURCHASE FROM PEOPLE WHO ARE BLIND
OR SEVERELY DISABLED

The JWOD Program: An Assessment of its
Impact on Small Businesses

OVERVIEW OF STUDY

The Javits-Wagner-O'Day (JWOD) Program operates in an arena where finite Federal contract dollars are available to qualified firms for the provision of products or services to the government. In such a finite market, competitive concerns naturally arise. The Committee for Purchase From People Who Are Blind or Severely Disabled, which administers the JWOD Program, has undertaken the following study to formulate a supportable response to concerns that have been expressed by the small business community about the impact of the program on the Federal procurement opportunities.

The study is presented in four parts:

- Part I: JWOD Share of Federal Procurement

  Examines the relative impact of the JWOD set-aside program in the Federal procurement arena in relation to other socioeconomic set-aside programs.

- Part II: JWOD Impact on Commercial Vendors

  Analyzes the effects of contract set-asides under JWOD on commercial contractors who previously supplied the items to the Federal government.

- Part III: Advantages/Disadvantages of Nonprofit Status

  Examines the affect of nonprofit status on the ability of community rehabilitation programs to compete in the Federal marketplace.

- Part IV: Rehabilitation programs and the small business community

  Reviews the relationship between community rehabilitation programs and the small business community at the local level.

BACKGROUND

Initiated in 1938 as the Wagner-O'Day Program to benefit people who are blind, today's Javits-Wagner-O'Day (JWOD) Program uses Federal procurement contracts to generate employment and training not only for people who are blind, but for individuals with other severe disabilities as well. Under the JWOD Act (41 U.S.C. 46-48c), the Presidentially appointed Committee for Purchase From People Who Are Blind or Severely Disabled, an independent Federal agency, decides which products and services used by Federal employees are suitable for inclusion in the JWOD Program. The Committee places such items on its Procurement List, thereby requiring Federal customers to purchase them from the sources designated by the Committee. Those sources are State or private nonprofit agencies (also known as community rehabilitation programs) which employ people with severe disabilities (and often provide a wide range of other services to such individuals). In addition, the Committee establishes fair market prices for the products and services on its Procurement List, and revises those prices as necessary over time to reflect changing market conditions. In the vast majority of cases, once an item is placed on the Procurement List, it stays there as long as the Federal Government has a need for that product or service and all of the procuring activity's requirements are being met..

The JWOD Act assures that people with severe disabilities will benefit from the Committee's actions by requiring that at least 75% of the total direct labor hours worked by each participating

nonprofit agency's employees be performed by individuals who are blind or have other severe disabilities. On individual JWOD contracts, between 60% and 100% of the direct labor hours are performed by such individuals; some of the indirect labor on JWOD contracts is also handled by people with disabilities. In many cases, the JWOD experience prepares individuals with disabilities for vocational options not otherwise available, including promotions to jobs with higher pay or greater advancement potential.

While the Committee for Purchase is responsible for all decision-making associated with the JWOD Program, two national nonprofit organizations have been designated by the Committee to help State and private nonprofit agencies participate in the Program. These organizations are National Industries for the Blind (NIB) and NISH. Funded by fees on nonprofit agencies' JWOD sales, NIB and NISH carry out a wide range of functions as directed by the Committee's regulations. These functions include allocating Government orders among nonprofit agencies; helping such agencies identify new items for consideration by the Committee and prepare to furnish such items; evaluating agencies' abilities to supply particular products and services; and assisting agencies in proposing fair market prices, resolving problems in the provision of JWOD supplies or services, and complying with Committee regulations.

PART I: JWOD SHARE OF FEDERAL PROCUREMENT

In addition to JWOD, Federal procurement set-aside programs with socioeconomic goals include the Small Business Administration's set-aside program for small businesses, and the 8(a) program for businesses owned by socially and economically disadvantaged individuals. These programs have in common their fundamental purpose of giving preference to individuals and businesses who, under completely open competition, would be unlikely to successfully compete for Federal procurement dollars. An even more fundamental commonality exists between the JWOD and 8(a) programs. Both these programs aim at improving economic access for people whose disadvantaged status is linked to characteristics that have caused discrimination: racial and ethnic status; and physical, intellectual or emotional disabilities. In fact, nearly one-third of the population served by the JWOD program

suffers double discrimination because they are disabled **and** members of a minority racial or ethnic group.

Despite their similarities in purpose and function, the JWOD program occasionally comes under criticism from the Small Business Administration for its selection of a contract that was previously held by a small, disadvantaged or minority-owned business. In part, this criticism stems from JWOD's preferential status over the other two programs. The order of preference is based on historical precedence as well as consideration for the difficulty faced by each population served in gaining alternative sources of revenue. The Federal Prison Industries (FPI) has first preference for Federal contracts for commodities, and JWOD has second preference. JWOD has priority over all other sources for service contracts.

JWOD and the small business programs may also come into conflict when they compete for the same or similar contracts. Most of the rehabilitation facilities that participate in the JWOD program are like small and disadvantaged businesses in terms of their size, limited capital, and intensive training needs of their workforce. Contracts selected for the program must be within the capability of a small enterprise, with limited workforce capability, to fulfill.

Relative Size of the JWOD Program

Figure 1 shows that, of the total $175 billion spent in Federal contract actions over $25,000 in FY 1994, $320 million went to the JWOD program, amounting to only .2% of all the Federal contract dollars reported. By comparison, small business as a whole was awarded $28.7 billion, 16.4% of the Federal contracts reported. Small business set-asides accounted for 3.5% of the reported Federal procurements, and 8(a) set-asides for disadvantaged businesses accounted for 3.0%.

Figure 1

Federal Contract Actions
over $25,000
1994[1]

	Amount	Percent of total
Total Contract Actions over $25,000	$174,688,951	100.0%
Small business	28,695,033	16.4
Small business set-aside	6,165,480	3.5
8(a) set-aside	5,213,912	3.0
JWOD	320,166	.2

It is apparent from this comparison that the JWOD program accounts for an extremely small portion of Federal contract dollars. The two small business set-aside programs take a much larger bite out of the total Federal procurement pie. The 8(a) Program is sixteen times, and the small business set-aside nineteen times the size of the JWOD Program.

Relative growth of the JWOD program

In the twelve year span for which data were available (Figure 2), both the JWOD program and the 8(a) program have expanded their respective share of Federal procurement dollars by 296%. For the JWOD Program, this has meant an increase of $212 million in annual sales, while the same percentage growth for the 8(a) program has meant an increase in annual sales of almost $3.5 billion. Hence, it would be misleading to say that the two programs have grown equally.

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[1]Federal Procurement Report. Federal Data Systems Division, General Services Administration, Feb. 7, 1995, pages 74-75. Table presents data for contract actions reported on SF 279, which are actions of $25,000 or more. These represent 89% of all Federal procurements reported.

Figure 2

JWOD and Small Business Share of
Federal Contract over $25,000[2]
(rounded to nearest million)

Year	Total Federal Procurement	Total Sm. Business	Sm. Bus. Set-Aside	8(a)	JWOD
1994	$174,689	$28,695	$6,652	$5,214	$320
1993	178,337	27,947	5,611	4,974	251
1992	177,786	28,230	6,180	4,788	244
1991	181,248	9,575	5,999	3,842	315
1990	163,822	25,402	6,620	3,359	181
1989	161,790	23,716	7,900	3,070	174
1988	174,098	25,671	11,433	3,390	165[3]
1987	178,515	26,706	11,561	3,115	164
1986	182,559	28,302	2,419	3,004	144
1985	182,604	25,247	7,949	2,535	134
1984	166,822	25,050	9,899	2,593	125
1983	152,336	20,940	7,691	1,761	108

Federal contract dollars going to small businesses have increased by $8 billion since 1983. The small business set-aside program, on the other hand, has declined since the late 1980's, losing $4.8 billion in annual sales in the last six years. Clearly, this decline in Federal contracts that are set aside for small business is beyond the scope of any impact the JWOD program could induce, and has not reduced the amount of Federal dollars going to small businesses in general.

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[2]Federal Procurement Report. Federal Data Systems Division, General Services Administration, "Total Federal Snapshot Report," compiled from annual reports for FY 1983-1993. Data includes only contract actions of $25,000 or more.

[3]The Federal Procurement Report does not report "sheltered workshop" data prior to 1989. For years in which the data is reported, SF 279 contract actions (contracts over $25,000) consistently account for about 50% of total JWOD sales. This percentage is used to estimate JWOD contracts of more than $25,000 for years prior to 1989.

In some instances, the previous contract for an item under consideration by the Committee was held by a minority or disadvantaged firm participating in the SBA 8(a) program. In these cases, the Committee considers the SBA commitment to the 8(a) firm. The Committee will not take away a contract held by an 8(a) firm until either the firm graduates from the 8(a) program, or the SBA's commitment to the firm expires. If the SBA indicates that its commitment to a particular 8(a) firm will extend beyond the firm's graduation from the 8(a) program, the Committee conducts an impact study before deciding whether to add the contract in question to its Procurement List.

At the request of the Federal contracting activity or the nonprofit agency, the Committee may add a contract held by an 8(a) firm to its Procurement List significantly in advance of that firm's graduation from the 8(a) program. This approach, which includes determining whether the SBA has a commitment to the firm after its graduation, benefits the 8(a) firm by providing advance warning that a contract will be performed under the JWOD Program upon the 8(a) contractor's graduation from the 8(a) program.

The Committee also seeks to reduce its impact on 8(a) firms by providing sufficient advance warning that a contract will be added to the procurement list at the end of the term of the current contract. The Committee adds such contracts to the JWOD program well in advance of the expiration of the current contract. The 8(a) contractor is thus informed, often one or two years in advance, that it will not be able to retain the contract upon graduation from the 8(a) program and expiration of the contract.

PART II: JWOD IMPACT ON COMMERCIAL VENDORS

Products and services added to the Procurement List for future provision by a nonprofit agency under the Javits-Wagner-O'Day (JWOD) Program are in many cases purchased by the Federal government under contract with a commercial contractor. The Committee's regulations provide guidelines to prevent creating a severe adverse impact on such a commercial contractor as the result of a Committee action. Under such guidelines, the Committee must determine that the level of impact on the current or most recent contractor for the product or service will not be severe.

Level of impact is primarily measured by the degree to which the contractor's annual sales would be diminished as a result of the addition. The value of the contractor's annual sales is usually obtained from Dun & Bradstreet. In cases where the Committee has been unable to obtain annual sales data for the firm from Dun & Bradstreet, a certified letter requesting sales data is sent by the Committee to the firm. In cases where the Dun & Bradstreet information indicate that the impact would be substantial, the Committee will send a certified letter to the firm if it has reason to doubt the accuracy or currency of the information. The Committee also solicits impact information through its formal notices of proposed additions, which are published in the Federal Register at least 30 days prior to its consideration of a proposed addition. The notice provides a 30-day comment period during which interested persons may submit data or comments regarding the proposed addition.

In addition to sales data, the Committee considers the cumulative effect of previous additions that have affected a contractor, as well as whether the contractor has been a continuous supplier to the Government of the specific commodity or service, and is therefore more dependent on the income from such sales. Any substantive comments received as a result of the notice of the proposed addition in the Federal Register or in response to the certified letter are also considered in making impact determinations.

The following analysis has been undertaken to determine whether the procedures described above have been effective in preventing severe adverse impact on commercial contractors. The analysis compares firms that did and did not respond to Federal Register or certified letter notifications with respect to their sales in 1993 and at the time the items for which they were the current or most recent contractor were added to the Procurement List. Samples selected and data sources for the analysis are described in the following section.

Methodology

For purposes of this analysis, "impact" is defined as the percent of a firm's annual sales accounted for by sales to the Federal Government of the commodity or service being considered for

addition to the Procurement List. Impact is the annual value of the contract for the item under consideration, divided by the firm's total annual sales. Sales data is obtained either from Dun and Bradstreet or from the firm itself.

"Firms impacted by JWOD" are defined as commercial firms that were the current or most recent contractor for a product or service proposed for addition to the JWOD Procurement List. For purposes of this comparative study, three subgroups of firms were defined. The following is a description of each subgroup, the method of selecting cases, and the sources of data.

Group 1: Firms that commented

Group 1 consists of firms that informed the Committee during the addition process that the proposed addition would have an adverse impact on the firm's business. The Committee determined, based on the sales data obtained, that the impact would not be severe, and the item was added to the Procurement List.

The Federal Register notice confirming the addition of a service or commodity to the Procurement List summarizes any comments received regarding the addition. Federal Register notices published between 1985 and 1992 indicated 74 cases, involving 64 different firms, where the current or most recent contractor commented that the addition would adversely affect its firm. The Committee's files contain data on the firm's sales at the time of the addition, the annual value of the proposed addition, and the percent of the firm's annual sales accounted for by the item added to the Procurement List. Annual sales data for 1993 is from Dun & Bradstreet.

All 64 firms that commented were included in Group 1.

Group 2: Firms that did not comment

Group 2 includes firms that did not respond during the comment period or at any other time regarding the impact of the JWOD addition on the firm's business. Data obtained by

the Committee showed that the impact would not be severe, and the item was added to the Procurement List.

The Committee maintains data on the current or most recent contractor for all additions to the Procurement List. A systematic sample (every 15th observation that fell between 1985 and 1992, from an alphabetical card file) was selected for inclusion in Group 2, for a total of 72 firms. Data on sales and impact were collected as above.

Group 3: Firms not impacted due to cancellation

Group 3 includes firms that the Committee determined would be severely impacted by the addition of the item to the Procurement List. In these cases, a decision was made by the Committee not to pursue consideration of the item.

All known cases between 1985 and 1992 where an action was discontinued due to potential impact on the contractor were included in the sample. This yielded a total of 43 cases for Group 3. Data on sales and impact were collected as above.

Comparison of Contractor Characteristics

Before comparing the impact of the Program on the three groups of contractors, it is important to consider if and how the groups differ from one another. Figure 3 presents data on the size of firms included in each sample, based on their annual sales[4]. The data show that Groups 1 and 2 contain firms of similar size, while Group 3 contains smaller firms. Statistically, firms in Groups 1 and 2 are from the same population of firms in terms of their size, but Group 3 is from a population of significantly smaller firms[5].

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[4]Values for annual sales at time of impact, annual value of addition, and annual sales in 1993 have been transformed to constant 1985 dollars to control for the effects of inflation.

[5]Tests of statistical significance are presented in Appendix I.

Figure 3. Average annual sales at impact for three groups.

Group	Annual Sales at Impact
1	$7,062,974
2	$5,555,273
3	$759,725

The next question asks whether the firms in Group 1 had more reason to comment on the potential impact than the firms in Group 2, since the two groups contain firms equal in size on average. Figure 4 shows that firms in Group 1 faced potentially greater impact from the proposed addition than did firms in Group 2. Both the annual value of the proposed addition, and the percent of the firm's annual sales that would be impacted, were significantly higher for Group 1 firms than for Group 2 firms. Firms in Group 3 would have been impacted by a much higher percent than either of the other two groups, even though the average annual value of the proposed addition was not significantly different, due to the small average size of the firms in Group 3. These findings confirm that the Committee's notification procedures, providing notice of proposed additions in the Federal Register or, in some cases, by certified mail, elicited responses from contractors whose businesses would sustain a greater loss of sales due to the addition.

Figure 4. Average value and percent impact for three groups

Group	Annual Value of addition	% Impact
1	$479,813	8.45%
2	$171,214	5.32%
3	$287,099	48.70%

Method of notification also varies by group. Overall, 53.8% of all the firms were notified by letter for the purpose of obtain-

ing their annual sales data, while 46.2% learned of the proposed addition from the Federal Register notice or some other source. Those notified by letter do not fall evenly into the three groups (Figure 5): 62% of the firms in Group 1 were sent letters, while only 13% of those in Group 2 were. All of the firms in Group 3

Figure 5. Method of notification, by group

Group	Certified Letter	Federal Register or Other Source
1	62%	38%
2	13%	87%
3	100%	0%

were sent certified letters. Due to the small size of most of these firms, they were not captured by Dun & Bradstreet records. Method of notification is highly associated with degree of impact since, as was noted earlier, certified letters may be sent to firms in cases where the impact appears high to verify available sales data. The relative importance of method of notification and degree of impact as determinants of whether a firm commented to the Committee cannot be separated given the inter-relatedness of these two factors.

Comparison of Impact on Contractors

On average, the firms in all three groups experienced growth in sales following the impact or potential impact caused by a JWOD addition (Figure 6). The noticeable growth in Group 3 firms confirms that these were small firms for which a small increase in dollar terms would mean a large percentage increase in overall sales. Despite the fact that Group 1 firms were impacted to a greater extent than Group 2 firms, Group 1 firms increased sales to a greater degree than did Group 2 firms.

Figure 6. Average percent change in sales for three groups

Group	% Change in Sales
1	31.85%
2	6.86%
3	228.52%

Overall, 51% of the firms in the study increased their sales over the time period studied (Figure 7). This percentage holds for each group as well. A higher percent of business failures among the Group 3 firms reflects the small size of these firms at the time of impact. Figure 7 shows no significant difference between the three groups in terms of whether they grew, declined or went out of business between the date of impact and 1993.

Figure 7. Percentage breakdown by group of business failure, increase or decrease.

	Business failed	Sales decreased	Sales increased
Group 1	8.2%	36.7%	55.0%
Group 2	8.3%	43.7%	47.9%
Group 3	19.3%	29.0%	51.6%
Overall Total	10.9%	37.5%	51.6%

Impact on Post-Impact Sales

The primary question of this analysis is whether the percent impact due to the JWOD addition is related to, or accounts for, the change in sales between time of impact and 1993 for the firms impacted. Since firms in Group 3 were not impacted, Group 3 is dropped from the analysis at this point, and Groups 1 and 2 only are compared.

Figures 8 and 9 illustrate the relationship between the percent impact (percent of sales lost due to the JWOD addition) and the percent change in sales between date of impact and 1993, for Groups 1 and 2, respectively. The figures show that there is no discernible relationship between the two variables. A correlation coefficient[6] of only .18 in the case of Group 1, and -.13 in the case of Group 2 confirms that, while other unknown factors may account for the change in sales experienced by these firms, the impact of the JWOD addition accounts for almost none of that change.

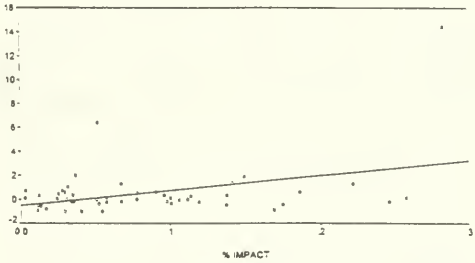

Figure 8. Relationship between percent of impact and percent change in sales for Group 1.

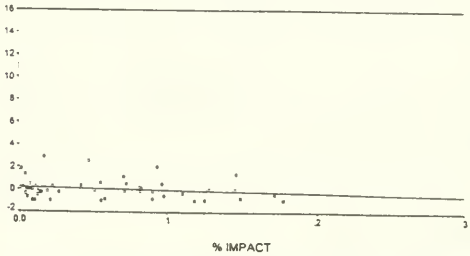

Figure 9. Relationship between percent impact and percent change in sales for Group 2.

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[6]Correlation coefficient (r) measures the relationship between variables on a scale from 1 (perfect positive relationship) to -1 (perfect negative relationship). A value of r=0 indicates no relationship at all.

Conclusions

The foregoing analysis illustrates that the impact on a firm's sales due to the addition of an item to the Procurement List does not explain the change in that firm's annual sales in years following the impact. Despite the higher impact resulting from the addition of an item to the Procurement List, firms in Group 1 fared better in subsequent years than did firms in Group 2. If subsequent growth or decline of the firms were due to JWOD impact, it would be expected that Group 2 firms would fare better than those in Group 1. The results obtained in this analysis suggest that the observed change in sales subsequent to the JWOD impact is not related to the JWOD impact. The outcome experienced by these firms could be explained by a variety of other unmeasured factors, including an underlying difference in the firms' management.

The conclusion that may be drawn from this is that the Committee's addition of items to the Procurement List did not severely impact the current or most recent contractors for those items. Furthermore, the analysis confirms that the Committee's definition of what is considered severe adverse impact successfully eliminates additions where the impact would have a measurable effect on subsequent sales of the firms impacted.

The analysis presented here confirms that those firms that commented that the proposed addition of an item to the Procurement List would severely impact their business faced a greater impact on their annual sales due to the addition than did firms that did not comment. Comments were made in response to two methods of notification: approximately three-quarters of the firms that commented had been notified by certified letter of the proposed addition; the remaining one-quarter responded to the notice published in the Federal Register. It may be concluded that the Committee's notification of firms, either by Federal Register notice or by certified letter, is a successful means of alerting firms of the potential impact, and furthermore that the notice successfully elicits response from firms that face a potentially higher impact.

PART III: ADVANTAGES/DISADVANTAGES OF NONPROFIT STATUS

In 1981, the U.S. General Accounting Office (GAO) outlined the special challenges faced by rehabilitation programs that justify their designation as nonprofit entities.[7] The report cites results of an earlier Department of Labor study[8], where it was found that three-fourths of the agencies surveyed had operating losses rather than operating gains. The GAO report points out that tax-free status is only a benefit if the organization has an operating gain on which income tax would otherwise be paid. The report also examined economic disadvantages faced by organizations that provide employment for people with severe disabilities, and concludes that nonprofit agencies generally incur added costs for serving and employing a disabled labor force--due to the low productivity of these workers because they require more supervision, floor space, equipment, administrative support and workers than a nondisabled labor force--which may offset the effect of whatever competitive advantages an agency may receive as a result of nonprofit status.

In 1994, the Committee surveyed nonprofit agencies participating in the JWOD Program in order to measure their potential tax advantage.[9] Many of the questions asked by the GAO study were repeated for purposes of comparison. The questionnaire included several questions about the agencies' nonprofit status. One of the criticisms that has been made of nonprofit organizations who compete with small business is that nonprofit status gives an

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[7]U.S. General Accounting Office, Stronger Federal Efforts Needed For Providing Employment Opportunities and Enforcing Labor Standards in Sheltered Workshops, HRD-81-99, U.S. Government Printing Office, September 28, 1981, pp. 92ff.

[8]U.S. Department of Labor, Sheltered Workshop Study: Workshop Survey, Vol. I, June 1977.

[9] The survey was sent to 202 agencies participating in the JWOD Program. The sample included all 76 agencies affiliated with NIB, and a random sample of 126 off the 477 agencies affiliated with NISH. Responses were received from 68 NIB and 86 NISH agencies, for an overall response rate of 76%.

unfair advantage to such organizations. According to this criticism, because they are not required to pay income tax on their earnings or surplus income, and in certain cases other taxes such as property, sales, etc., nonprofit organizations are able to lower their prices and underbid for-profit businesses.

Operating Gain/Loss. In its survey, the Committee gathered data that could be compared to the 1977 Department of Labor data.[10] Agencies were asked to calculate their operating gain or loss in the same manner used in the earlier study. Findings show that a greater percentage of agencies reported operating gains in the JWOD survey than in the previous Department of Labor study (Figure 10). Almost half (44.4%) of the agencies surveyed reported operating gains, compared to only about 25% in the earlier survey.

Figure 10. Operating Gain/Loss

	Total	NIB	NISH
% Reporting Operating Gain	44.4%	25.4%	58.6%
% Reporting Operating Loss	51.0%	64.2%	41.4%
% Not Reporting	4.6%	10.4%	0%

Among the JWOD agencies, NISH agencies reported operating gains more often (58.6%) than did NIB agencies (25.4%). NIB agencies have a rate of operating loss roughly equivalent to that of agencies surveyed nearly 20 years ago. A possible explanation for the difference between NIB and NISH agencies is that NIB agencies rely much more heavily on income from their work program sales than do NISH agencies. Sales generated by the work program account for an average 73% of total earned operating income for NIB agencies, while accounting for only 32% of total earned operating income for NISH agencies.

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[10]The sample of agencies included in the DoL study and in the present survey may be significantly and systematically different from each other, and therefore any direct comparisons may not be valid.

A second possible explanation that could work in tandem with the first is that NISH agencies support their work programs predominately with service contracts, which generally have lower start-up and overhead costs, and where prices more often match or exceed the agency costs, than the manufacturing contracts that are the primary source of work for NIB agencies. Diversification into service contracting for agencies serving people with disabilities has happened completely within the past 20 years, so that the agencies surveyed by DoL in 1977 would have been, like the NIB agencies today, primarily involved in manufacturing.

Agencies also reported the dollar value of their operating gain or loss (Figure 11). For the total sample of JWOD agencies, the

Figure 11. Value of Operating Gain/Loss

	Total	NIB	NISH
Average Gain	$206,112	$207,045	$205,771
Average Loss	-$453,222	-$677,022	-$202,294
Average Earned Operating Income	$4,792,118	$4,968,127	$4,668,437
Ave. Gain as a % of Operating Income	4.3%	4.2%	4.4%
Ave. Loss as a % of Operating Income	9.4%	13.6%	4.3%

average operating gain was $206,112, the average operating loss was -$453,222. The table shows that while the average gain was consistent between NIB and NISH agencies, NIB agencies experienced significantly higher operating losses. When the magnitude of the earned operating income is held constant, as in calculating gain and loss as a percentage of total earned operating income, it is still evident that the NIB agencies experience significantly higher operating losses.

Taxes Paid. Although they are not required to pay income taxes, nonprofit agencies are required to pay a variety of other taxes to local, State and Federal governments. As Figure 12 shows, nearly 90% of the nonprofit agencies surveyed pay payroll taxes for their employees. Other major taxes that are paid by the

agencies include property tax and sales tax. Only 8.5% of the agencies reported that they did not pay any taxes.

Figure 12. Taxes Paid by Nonprofit Agencies

Type of Tax	% of Agencies that pay
Property Tax	23.5%
Payroll Tax	89.5%
Sales Tax	15.0%
Other Federal, State or Local Tax	25.5%
No Taxes paid	8.5%

Pros and Cons of Nonprofit Status. The survey asked agency representatives what, in their perception, were the three major advantages of nonprofit status. To balance the picture, the survey also asked what three major disadvantages there were to nonprofit status. More consensus was found among agencies about what the advantages of nonprofit status are than the disadvantages (Figure 13). As might be expected, the most consistently reported advantage is reduced taxes. However, most agencies reporting this advantage focussed not on the tax break itself, but on the fact that

Figure 13. Advantages of Nonprofit Status

"Pros" of Nonprofit Status	% Who Agree
Reduced taxes offset extra costs	62.7%
Gives agency access to donations, contributions	59.4%
Gives agency access to Federal and State programs	26.7%
Increases community support, volunteer help	18.3%
Makes a positive public perception, good for public relations	11.7%
Allows agency to focus on and reinvest in mission	11.1%
Helps in relationships with for-profit businesses	5.2%
Improves access to potential customers	3.9%
Agency can associate with other nonprofits	3.2%

reduced taxes offset other costs that are incurred as a result of performing their mission of serving people who are blind or severely disabled. Almost as commonly reported is the advantage of having access to donations and contributions, presumably because this helps offset the operating losses experienced by many of the agencies. Many of the other advantages reported echo the theme of access to resources such as volunteer help, and the agencies' ability to focus on and reinvest in their mission rather than worry about the bottom line of turning a profit.

Greater variation was evident among the agencies in what were considered the three major disadvantages of nonprofit status (Figure 14). Only one-fifth agreed on the most common response, that nonprofit status creates additional paperwork and administrative requirements. Other types of disadvantage revolve around the negative public perception that comes with nonprofit status, making it difficult to secure capital, or to work with for-profit businesses. Many agencies reported that other businesses expect them to have lower prices because they are "non-profit", and do not treat them as a real business. Finally, because of limited operating budgets, agencies are faced with constraints on hiring personnel because of low salaries, and are forced to rely more heavily on volunteer help.

Figure 14. Disadvantages of Nonprofit Status

"Cons" of Nonprofit Status	% Who Agree
Creates paperwork, additional administrative work	20.1%
Creates negative public image of agency and its work	16.2%
Makes it hard to secure capital, expand business	15.5%
Creates hostility from for-profit businesses	12.3%
Not seen as a "real business"	12.3%
Higher overhead costs due to labor force with disabilities	11.6%
Public expects low prices, operating loss	10.3%
Limits recruitment of personnel due to low salaries	7.1%

Extra costs. Nonprofit agencies serving people who are blind or severely disabled experience operating costs that do not affect for-profit businesses or even other nonprofit organizations. These additional operating costs result from the mission of the agency itself, to train and employ people with severe disabilities whose productivity level is lower than that of nondisabled workers. The 1981 GAO report cited above postulated that higher costs were incurred by agencies employing people with severe disabilities due to lower productivity of the workers, and the need for more supervision, floor space, equipment, administrative support and workers.

Agencies surveyed were asked whether employing people who are blind or have other severe disabilities increases, decreases, or does not affect their operating costs. As Figure 15 shows, 83% of the agencies responded that it increases their costs. The percentage is slightly higher for NIB than for NISH agencies, based on their manufacturing rather than service orientation. A small portion of the agencies surveyed responded that their costs were not affected by employing people with disabilities, but almost no agencies reported that costs decreased as a result of employing people with disabilities.

Figure 15. Costs of employing people with disabilities

	Total Sample	NIB	NISH
Increases Costs	83%	91.0%	77.0%
Decreases Costs	.7%	0%	1.1%
Does Not Affect Costs	13.7%	7.5%	18.4%

In addition to the reasons for higher costs stated in the GAO report, the agencies that were surveyed indicated that the following are sources of additional cost:

- extra fixturing
- specialized equipment
- higher insurance usage
- transportation
- initial training costs
- job modification

Because their mission is to provide training and employment for people with disabilities, the agencies surveyed make labor decisions differently than for-profit businesses. For example, one agency reported that in establishing a project they may look for ways to expand the labor content in order to provide more job opportunities, whereas a commercial company would look for ways to eliminate labor and streamline labor costs. Sometimes the agencies keep employees working when there are no orders to avoid layoffs, a phenomenon that seldom if ever occurs among for-profit firms.

About 20% of the agencies surveyed indicated that they had calculated the costs associated with employing workers who have disabilities. The percentages by which costs are reportedly increased range from 11% to 50%. However, some agencies estimated the costs to be 2.5 to 4 times as high as the costs associated with a nondisabled workforce would be. These latter figures are estimates based on the productivity levels of the workers, and do not reflect actual calculated findings.

PART IV: RELATIONSHIP WITH SMALL BUSINESSES

Although by Federal definition nonprofit agencies are not small "businesses", size and sales volume would place most of the agencies participating in the JWOD Program in the ranks of small business were they operating for profit. Like most small businesses, the agencies serving people with disabilities conduct much of their business with other small businesses. There are no previous studies that document the total resources that flow to small businesses from nonprofit agencies serving people with disabilities. Nor, for that matter, have any studies documented the factors that prevent greater cooperation between nonprofit agencies and the small business community. By means of a series of questions regarding their interactions with small businesses, the survey of nonprofit agencies participating in the JWOD Program sought to fill that information gap.

Contractual relationships. JWOD regulations require that each nonprofit agency participating in the JWOD Program "accomplish the maximum amount of subcontracting with other nonprofit agencies and small business concerns" that is feasible for the

agency. In 1986, NIB surveyed their affiliated agencies to determine what portion of their purchasing dollars went to small businesses. Their survey revealed that purchases of raw materials and components from small business concerns accounted for an estimated 65 percent of the total. An additional 8.6 percent was purchased from other JWOD-affiliated agencies. In total, then, 71% of all purchases from commercial industry came from small businesses.

To provide comparable data for the earlier NIB study, the survey asked agencies to report the amounts spent on purchases from, and subcontracts with, small businesses, other nonprofits, and other sources (Figure 16). The results show that slightly over half of all purchase and subcontracting dollars go to small businesses. An additional 5.8% of purchases are made from other nonprofit agencies, bringing the total to 63.1%. Purchases from small businesses average $926,093 annually per agency; subcontracts with small businesses average $81,742 annually per agency. While the percent of purchases that are made from small businesses is somewhat lower than the results of the earlier NIB survey indicated, it is still noteworthy that two-thirds of all purchases are made from small business entities.

Figure 16. Purchases and subcontracts

Source ▸ ▾Type of expense	Small Businesses	Other Nonprofits	All other Sources
% of all purchases	57.3%	5.8%	36.8%
% of all subcontracting dollars	54.7%	35.5%	9.6%

Availability and price were the two major reasons cited (33% and 20% of respondents, respectively) why agencies did not make more of their supply purchases from small businesses.

Over one-third of all subcontracting dollars go to other nonprofits, bringing the total percent of subcontracting dollars that benefit small businesses to 90.4%. Clearly, agencies participating in the JWOD Program have complied with the regulation requiring subcontracting activity that is carried on with small businesses is maximized.

Allegations of unfairness. Agencies were asked whether there had been any allegations made by small businesses in their community about unfair competition on the part of the agency. Only 20% responded affirmatively. Many of the allegations concerned the agencies' potential for "low-balling" bids because of lower wages paid to their employees. Typically, these allegations were withdrawn once the small businesses were apprised of the agencies' mission to employ people with severe disabilities, the operating costs associated with that mission, and the payment of wages based on productivity level.

Cooperative activities. The questionnaire included a question asking agencies to report any other cooperative activities between themselves and small businesses. Nine percent responded that they had been engaged in such activities. They cited working with small businesses in Rotary Clubs and Chambers of Commerce; educating businesses about people with disabilities; and having small business participate on their Business Advisory Committees.

Placement of Qualified Workers

One way in which small businesses and nonprofit agencies serving people with disabilities can cooperate is in finding competitive employment in the local community for people with disabilities. Both sides have something to gain from cooperating in this effort. Agencies participating in the JWOD Program are required to actively engage in seeking competitive placements for their clients who are both capable and interested in such placement. The Americans with Disabilities Act (ADA) imposes requirements on most businesses to provide employment opportunities for qualified applicants with disabilities. Nonprofit agencies that train people with disabilities in work skills are a potential source of qualified employees for small businesses seeking to comply with the ADA.

To gauge the degree to which cooperation is taking place between rehabilitation agencies and small businesses, the survey asked agencies to report on the placements they made during 1993. Figure 17 reports placements made to small businesses and other businesses. For the program overall, the vast majority (78.6%) of placements are made in small businesses. However, placements made by NIB agencies (serving people who are blind) are less

likely to be in small businesses than placements made by NISH agencies. A possible explanation for this is that a higher proportion of NIB placements are in manufacturing occupations, and manufacturing industries tend to be larger than service businesses.

Figure 17. Placements to competitive employment (number/percent)

Where placed	Total Sample	NIB Agencies	NISH Agencies
Small Businesses	5,674 (78.6%)	326 (47.2%)	5,348 (81.9%)
Other Businesses	1,549 (21.4%)	364 (52.8%)	1,185 (18.1%)
Total	7,223	690	6,533

The questionnaire asked agencies to indicate what factors hindered their attempts to place clients in competitive employment during 1993 (Figure 18). Topping the list is lack of transportation to the work site. Other important hindrances are lack of suitable jobs, and hours of work unsuited to the workers' needs. Less common but still important problems are the employers' failure to offer wages and benefits comparable to what workers could earn at the facility. Many agencies reported that clients chose not to leave the facility for this or other reasons. SSDI benefits, thought to be a major disincentive to seeking work, was explicitly mentioned by only a few agencies, but could also be a reason why clients chose not to leave the facility.

Figure 18. Factors that Hinder Job Placement

FACTORS	% RESPONDING
No transportation to work site	70.5%
No suitable jobs available	53.4%
Hours of work not suited to worker	49.6%
No suitable benefits available	30.7%
Wages were too low	26.1%
Employer couldn't accommodate needs	26.1%
No clients ready for placement	18.3%
Client chose not to leave facility	15.0%
Employer refused to hire disabled	11.7%
Poor local economy	7.1%
Limited or no placement program	5.8%
Lack of family support	3.2%
Employers not aware of capabilities	1.9%
SSDI disincentives	1.9%

The imperatives of the ADA rely on businesses' willingness to provide "reasonable accommodation" to meet the needs of potential employees with disabilities. Nonprofit agencies serving people with disabilities have had ample experience in providing such accommodations, and are in a position to assist other businesses less familiar with the types of accommodation that may be offered to potential employees. Forty-three percent of the agencies surveyed replied that they provide ongoing assistance to other small businesses in accommodating the needs of workers with disabilities. Another 35% of the agencies occasionally offer such assistance. Only 20% of the agencies surveyed indicated that they had never offered assistance in providing reasonable accommodation.

Figure 19 summarizes the types of accommodations that agencies have helped employers provide. Most commonly, agencies assist other small businesses in modifying equipment to serve the needs of workers with disabilities. Almost as common is restructuring

the requirements of the job, in ways such as modifying the tasks required to be performed, or perhaps "carving out" job responsibilities suitable for the employee with disabilities and reassigning inappropriate tasks to other employees. Agencies commonly assist small businesses in improving accessibility either to the job or at the job site.

Figure 19. Accommodation assistance provided by agencies

TYPE OF ACCOMMODATION	% RESPONDING
Assist in modifying equipment	58.8%
Restructure requirements of job	54.2%
Improve accessibility at work site	46.4%
Improve transportation to work site	41.1%
Provide modified work schedule	40.5%
Modify exams, training materials, etc.	33.9%
Provide readers or interpreters	33.3%

Response to ADA

Conceptually, the ADA should be a tool for nonprofit agencies serving people with disabilities, opening doors in their communities to potential placement opportunities for their clients. The survey asked a series of questions to gauge the perceptions of agency personnel about the usefulness of the ADA in promoting placement of persons with disabilities into competitive employment.

As Figure 20 shows, nearly 100% of the agency personnel responding to the survey are knowledgeable about the ADA and the employment rights it offers to people with disabilities. Eighty-five percent of the agencies report that they counsel their clients about their rights under the ADA. This fact contrasts with results of the 1991 survey of the JWOD population that showed 82% of JWOD employees were not aware of the ADA. Since 1991, when the ADA was fairly new and applied to only large businesses, increased implementation of the ADA requirements has helped make more people aware of its provisions.

Two-thirds of the agencies surveyed have attempted to educate small businesses in their communities about their responsibilities under the ADA. One JWOD-affiliated agency in Texas received a grant from the Rehabilitation Services Administration to set up a program for training local businesses about compliance with the ADA.

Feelings are mixed about whether the ADA has actually helped change the way employers view people with disabilities. Half of the agencies surveyed responded that they thought the ADA had been helpful in changing employers' attitudes. One quarter of those surveyed (24.3%) reported that the ADA has directly helped them make a job placement.

Figure 20. Response to ADA

QUESTION	% RESPONDING YES
Are you knowledgeable about the employment rights according individuals with disabilities under Title I of the ADA?	98.7%
Do you counsel your clients about their rights under the ADA?	85.7%
Have you attempted to educate small businesses in your community about their responsibilities under the ADA?	66.7%
Have you found the ADA helpful in changing other employers' attitudes about the productive capabilities of people with disabilities?	50.3%
Has the ADA been directly responsible for any successful competitive job placements by your agency?	24.3%

CONCLUSIONS

This report has assessed several aspects of the potential impact of the JWOD Program on the small business community. In part, this analysis was motivated in response to criticism of the program's direct or indirect impacts; in part, it is an attempt to identify areas of potential cooperation between JWOD agencies and small businesses.

APPENDIX I

Tests of statistical significance

General notes

A significance level of .05 is used throughout the analysis. All dollar values have been adjusted to constant 1985 dollars to control for the effects of inflation.

1. Figure 3: Annual sales at impact

Analysis of Variance for 3 Groups:
F= 12.72, p=.0000

Mean	Group	Group 1	2	3
7,062,974	1			
5,555,273	2			
759,725	3	*	*	

(*) indicates significant difference between specified groups

T-test for Groups 1 and 2:
t=1.16, p=.248

2. Figure 4: Annual value of contract

Analysis of variance for 3 Groups:
F=3.96, p=.020

Mean	Group	Group 1	2	3
$479,813	1			
$171,214	2	*		
$297,099	3			

(*) indicates significant difference between specified groups

T-test for Group 1 and 2
t=2.64, p=.010

3. Figure 4: Percent impact

Analysis of variance for 3 Groups:
F=103.91, p=.0000

Mean	Group	Group 1	2	3
8.45%	1			
5.32%	2	*		
48.70%	3	*	*	

(*) indicates significant difference between specified group

T-test for Group 1 and 2:
t=2.81, p=.006

4. Figure 6: Percent change in sales

Analysis of variance for 3 Groups:
F=.6.70, p=.0017

Mean	Group	Groups 1	2	3
31.85%	1			
6.86%	2			
228.52%	3	*	*	

(*) indicates significant difference between specified groups

T-test for Groups 1 and 2
t=1.20, p=.234

5. Figure 7: Difference in business growth, decline or failure

Chi-square test for 3 Groups:
Chi sq.=3.99, p=.40

6. Correlation of percent impact by percent change in sales for Groups 1 and 2

Group 1: r=.1803, p=.215
Group 2: r=-.1347, p=.341
Groups 1 and 2: r=.0938, p=.351

IRA L. KEMP
7728 RYDAL TERRACE
ROCKVILLE, MARYLAND 20855

August 7, 1996

Representative Jan Meyers
Chair, Committee on Small Business
U.S. House of Representatives
Rayburn House Office Building, Room 2361
Washington, DC 20515-6315

Dear Representative Meyers:

I am writing as the former Chairperson of the Committee for Purchase From People Who Are Blind or Severely Disabled, a part-time position I held in addition to my full-time job as Associate Deputy Assistant Secretary (Contracting) for the U.S. Air Force. As the senior civilian member of the Air Force contracting community, I was appointed to the Committee by President Reagan in May 1983 and reappointed by President Clinton in November 1994. In June 1991, I was chosen by my fellow Presidentially appointed Committee members to serve as Chairperson. I performed in that capacity until my July 1996 retirement after 36 years of Federal service.

In a hearing on July 18, 1996, you and your Small Business Committee colleagues received testimony from several sources who criticized the Javits-Wagner-O'Day (JWOD) Program, which is administered by the Committee for Purchase From People Who Are Blind or Severely Disabled. As someone who chaired that Committee in recent years and played an active role for almost a decade prior to that, I believe it is incumbent upon me to offer a response on behalf of current and former Committee members. I know that others will respond to some of the factual errors made by the various witnesses, so I will limit my comments to addressing what I consider to be inappropriate and unwarranted attacks on the integrity of the Committee and, by extension, the JWOD Program.

As noted above, all of the Committee members are appointed by the President and each takes his or her responsibilities extremely seriously. Eleven of the members hold other full-time executive positions in the Federal Government, while four are private citizens, accomplished in their own fields, and knowledgeable about the employment needs of people with severe disabilities. To suggest that these individuals would ignore the JWOD Act or abdicate their decision-making responsibilities to another organization reflects a lack of understanding of the JWOD process and a misjudgment of the members' characters.

For 13 years I participated in and observed the deliberations of the Committee. Based upon that experience, I can assure you that its members and staff understand their responsibilities and have made every effort to give full hearings to those who oppose particular actions under consideration by the Committee. In fact, our efforts to be scrupulously fair to all interested parties have at times resulted in questions from organizations serving people with severe disabilities about the extent to which we were listening to private, profit-making firms contesting a particular proposed action.

Contrary to the statements of one of your witnesses, Congress understood in enacting the JWOD legislation that some impact on (or competition with) private industry was inherent in the nature of this program. In this, it is no different from other special Federal procurement programs, such as those benefitting small businesses. The impact of the JWOD Program, however, is extremely limited. Overall, JWOD sales represent less than one-half of one percent of total Federal contract purchases and are only slightly over one percent of total Federal small business contract purchases.

Most important to note is that the Committee carefully assesses the impact on the firm that is the current contractor at the time it decides whether or not to add a proposed product or service to the JWOD Program. In the process, each individual Committee member takes into account all the information submitted by that contractor or any other party. Only if a majority of the Committee members are convinced that the proposed action will not threaten the viability of the firm involved does the Committee vote to create employment for people with severe disabilities by adding the item to the JWOD Program.

In closing, as one who is intimately familiar with all aspects of the Federal procurement process, I want to take this opportunity to express my long-held opinion that the JWOD Program is an exceptionally worthwhile endeavor. If you decide to hold hearings to let the "other side" of the JWOD story be told, I would be proud to testify to the integrity and effectiveness of this unique program.

Sincerely,

Ira L. Kemp

3300 49th Street
Des Moines, Iowa 50310

August 7, 1996

The Honorable Jan Meyers
U.S. House of Representatives
Committee on Small Business
2361 Rayburn Office Building
Washington, D.C. 20515-6315

Dear Congresswoman Meyers:

I was most dismayed to learn that your July 18 hearing on the issue of unfair competition became a forum for maligning the Javits-Wagner-O'Day (JWOD) Program and the thousands of Americans with severe disabilities employed through it. Thus, I am writing these comments and requesting that they be included in the hearing record.

I serve as a member of the Committee for Purchase From People Who Are Blind or Severely Disabled (Committee)--the Federal agency which administers the JWOD Program nationwide. As an individual with a disability it is my role to represent, as a private citizen, other individuals with severe disabilities. My appointment to this body was with merit. I worked for ten years with the Easter Seal Society of Iowa, Inc. I've served as Executive Secretary of the Iowa Governor's Committee on Employment of People with Disabilities; Vice Chair of the Board of Directors of Goodwill Industries of America, Inc., and on the board of the National Rehabilitation Association, to name a few. My entire life has been dedicated to expanding job opportunities for people with disabilities and serving as a national spokesperson and advocate for disability rights.

Thus, you can understand my consternation when reading the comments made at the hearing by Messrs. Liberman, Hanson, Kemp and Stack. Their comments were long on insinuations and short on facts. I am writing this response as the voice of those whom I serve and represent on the Committee, who were not present or heard from at your hearing.

The Committee is one of the smallest agencies in the Federal government. The staff consists of *18 persons* and operates with a budget of $1.8 million. Contrary to Mr. Liberman's testimony, the Committee never loses sight of its constituency--people with severe disabilities. We have **four** representatives appointed to speak for the concerns and rights of people with disabilities.

Several other **inaccuracies** need to be addressed for the record as well. The following statements address these issues:

"The Committee awards the contract to NISH who...." (Liberman) This is false. The Committee directs the Federal agency responsible for procuring the product or service to buy that

item from one or more State or local nonprofit agencies employing people with severe disabilities (also called Community Rehabilitation Programs--CRPs). The Federal agency then contracts directly with the nonprofit agency(ies)--**not with NISH.** NISH is the national private nonprofit organization which provides technical assistance in the areas of engineering, training, marketing and procurement to CRPs participating in the JWOD Program.

"Less than 10 - 15% of the labor required for most JWOD contracts is actually done by disabled workers."(Liberman) This is misleading at best..a lie at worst. The records of those rehabilitation programs participating in JWOD are reviewed regularly by NISH, the Committee and the Department of Labor. Seventy-five percent of the direct labor employed in the agencies must be performed by people with severe disabilities.

"The disability community itself is very critical of the way this program operates...." (Liberman) Some segments of the disability community are critical of a JWOD contract if they perceive it as taking place in a "sheltered" setting. Some also criticize the entire network of rehabilitation programs and almost anything that isn't perceived as "mainstream." The 541 Community Rehabilitation Programs which provide job training and employment through JWOD and which serve tens of thousands of people with disabilities, however, will disagree. From my personal experience in the disability community, I can tell you that thousands of people with severe disabilities not only love the program but depend on it for their livelihood and ability to live with dignity in their communities.

The ADA has made the JWOD Program out of date. (Inferred by several speakers) The Americans with Disabilities Act (ADA) will *not* replace the JWOD Program as a means for CRPs to provide training and employment for people with disabilities. CRPs provide these vital roles in their local communities. The ADA has made a definitive statement about the civil rights of people with disabilities and, indeed, has provided better access to buildings, transportation and communications. According to the DOL, it is also one factor identified as contributing to the small increase in the number of people with disabilities who have jobs. But the ADA is presently under attack by the very business community that is now singing its praises before you. ("The 104th Congress can do all of us a big favor by rewriting this law (ADA)..." This statement is taken from US Chamber of Commerce President Richard Lesher in Meltdown on Main Street). JWOD is one among many training and employment choices for people with disabilities, but to expect the ADA to compel American firms to provide instant vocational training and employment is unrealistic and foolish and a disservice to the people it was supposed to assist.

Mr. Evan Kemp says "In JWOD's case, it is clear that able-bodied bureaucrats are filling their pockets with money that is supposed to go to disabled workers. " This is a scurilous comment. It's hard to imagine staff of an agency the size of the Committee, with a nominal appropriation of $1.8 million, filling their pockets with anything. My belief is that Mr. Kemp, for whom I once had enormous respect, was provided misleading information on which to base this ridiculous remark. The Committee has a staff of individuals with and without disabilities.

As I indicated earlier, there are four of us serving on the Committee who are designated to represent and advocate for people with disabilities. All of us have disabilities ourselves.

Mr. Liberman's testimony indicates that he proposed a "formula" which would result in less impact on business and more employment for people with disabilities. We who serve on the Committee welcome innovative ideas which would improve job opportunities for people with severe disabilities. Yet, Mr. Liberman's proposal for a new JWOD Program would result in a *bigger* bureaucracy with *less* chance for meaningful employment for people with severe disabilities. Mr. Liberman cites difficulties he presently has with a Federal agency of under two dozen people. What on earth would any businessperson do with the agency that would be required to administer a formula which takes nine pages and eight footnotes to describe?

Mr. Stack testified: "The mentality of the persons who operate those (JWOD) workshops do not train, they stifle...." Supported employment and JWOD employment are not opposite ends of the employment spectrum, but rather, several choices on a full menu of opportunities for people with disabilities. In many states across the nation JWOD service jobs qualify as supported employment opportunities. Seventy-three percent of the JWOD contracts managed by NISH-associated CRPs alone are situated in service opportunities located outside the facility--in other words, in the same community that Mr. Stack describes. The irony of Mr. Stack's testimony is that the individual he cited as a successful illustration of supported employment, Harold, a laundry worker, could have found identical employment in the Javits-Wagner-O'Day Program. There are thousands of Harolds working in JWOD data processing, switchboard operations, receptionist, patient escort, mailing services, groundskeeping, food service, laundry and recycling projects, to name a few. Furthermore, 55-60% of all supported employment opportunities are offered today through the *very same* community rehabilitation programs that Mr. Stack criticizes. To denegrate or eliminate any of these programs will limit the opportunities for many individuals for full employment and independence.

The inference in Mr. Stack's comments is that to eliminate the "funding" of the JWOD Program would free up more money for supported employment. This is not the case. The JWOD sales figures represent *purchases* from Federal agencies--purchases that would fall to other businesses, not to community rehabilitation programs, if JWOD were to end. This does *nothing* to improve and expand job opportunities for people with disabilities.

The inference in Mr. Stack's and Mr. Kemp's testimony is that the cost of the JWOD Program is too high. I personally believe that the cost of the JWOD Program versus the return is an example of government at its best--not worst. JWOD opportunities continue to permit individuals with severe disabilities to eliminate or reduce their dependence on a variety of public assistance programs. The transition from Social Security Disability Insurance (SSDI), Disability Income (DI) and Supplemental Security Income (SSI) alone produces significant savings from entitlement programs. (In 1990, 3.3 million disabled workers were enrolled in DI and received on average, about $660 a month. SSI enrollees totaled 2.4 million who received, on average, about

$360 a month.) Furthermore, by earning a steady income, many JWOD employees become taxpayers - not tax users.

"Slave wages." (Several speakers) Wages through the JWOD Program offer more opportunities for people with disabilities to live independent lives than most jobs in the community. Real wages for the least skilled workers in this country have declined since the 1970s (according to a recent GAO report) but wages in the JWOD program have increased annually. At present, the *average* hourly wage for a JWOD employee in a NISH-affiliated CRP is $6.26 per hour.

Perhaps the best example is an excerpt of statements taken from an actual vote letter dated July 26, 1996. This is for a proposed service contract located in Stockton, California, at the Defense Reutilization and Marketing Office. The contracting agency is the Defense Logistics Agency and the nonprofit agency identified to perform the service is the Association for Retarded Citizens-San Joaquin, Stockton, Calfornia. Individuals with severe disabilities will gain an estimated 10.8 work years of employment and earn real wages of between $8.82 and $12.43 per hour to perform material handling/warehousing and janitorial functions.

"People with severe disabilities 'can and ought' to compete for jobs along with all Americans." (Kemp) I agree with Mr. Kemp's comments. Unfortunately, the enormous competition for jobs continues to grow each day. Therefore, a business can be very selective in whom they employ. Employers asked to choose between an employee who may require a number of accommodations (such as job coaches, training and personal counseling), and job modifications at the work site to succeed in the job or someone who is already trained and does not require special assistance will, most likely, look to the latter. Indeed, if businesses had demonstrated well their collective commitment to employ people with disabilities over the years, JWOD and the ADA would have not been necessary. The new Welfare Reform Bill may lessen opportunities for people with severe disabilities to obtain jobs--since it will send more unskilled people flooding into the labor market to compete for jobs. This makes the road to economic self-sufficiency that much more difficult for people with severe disabilities who depend on CRPs for training and employment opportunities in programs like JWOD.

Representative Meyers, I trust that you will take my comments to heart and include them in the official record of your recent hearings. I would be happy to meet or talk with you directly should you desire.

Thank you for your cooperation.

Sincerely,

Evelyne Jobe Villines

Statement of

Judith D. Moore
President and CEO
NATIONAL INDUSTRIES FOR THE BLIND

To the

COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES

Response to Hearing held on July 18, 1996
Submitted August 7, 1996

On behalf of National Industries for the Blind (NIB), I am pleased to submit this statement for the record and to acquaint the Committee with our mission, accomplishments, and goals for the future. The work we do in providing employment opportunities for more than 5,300 people who are blind meets a need that remains unmet by any other source.

Alleged government-sponsored unfair competition by nonprofit organizations with small business is an important topic, deserving a balanced examination. It is our hope that the comments below will help the Committee more fully understand the Javits-Wagner-O'Day Act and the role that NIB plays in satisfying the purpose of the Act.

OVERVIEW

Over two thirds of all people with disabilities are out of work, and this inequality persists even with the enactment of the landmark Americans with Disabilities Act. To meet this challenge, NIB creates high quality employment opportunities for people who are blind. Made possible through participation in the Javits-Wagner-O'Day program, NIB and its associated industries offer people who are blind employment with average wages at $7.39 per hour including benefits, training to compete in the job market, a wide variety of manufacturing and service jobs, and opportunities for upward mobility and placement in the community.

NIB accomplishes this task by providing high quality products and services at fair prices to the federal government while saving millions of taxpayers' dollars. Through its on-going partnerships with small and large businesses, NIB continues to refine and develop new employment opportunities.

JWOD'S ORIGIN

In the 1930's, Dr. Robert Irwin, Executive Director of the American Foundation for the Blind, expressed grave concerns within the field of blindness about the high rate of unemployment among people who are blind, a major problem that continues even today. Senator Robert Wagner and Representative Caroline O'Day realized that there were very few job opportunities for people with severe visual impairments. They approached Congress with a strategy that would provide people who are blind an opportunity to support their families, become tax payers rather than welfare recipients, and, at the same time, provide the Federal Government with useful, quality products at fair prices.

Congress responded with the passage of the Wagner-O'Day Act in 1938, which ensured that the Federal Government would agree to purchase products from industries serving people who are blind as long as such products were of high quality, sold at fair market prices, and delivered on time. Due to the success of this program for people who are blind, Congress expanded the Wagner-O'Day Act in 1971 to include agencies serving people with other severe disabilities and to add the procurement of services to the Federal Government as well as products. The Act is now known as the Javits-Wagner- O'Day (JWOD) Act(41 U.S.C. 46 et seq.).

JWOD'S OPERATION

The Committee for Purchase from People who are Blind or Severely Disabled (Committee for Purchase) is a small independent federal agency, created by the JWOD Act, that administers and promotes the JWOD Program. Its 15 members include senior officials from major federal procurement agencies. The Committee for Purchase decides which items and services are suitable for addition to the JWOD "Procurement List" and what fair market price the government pays.

The Committee for Purchase has designated NIB and NISH, formerly known as National Industries for the Severely Handicapped, as the two Central Nonprofit Agencies responsible for the allocation and administration of government contracts to their respective associated agencies. The JWOD Act requires that, in order to participate in the JWOD program, nonprofit agencies associated with NIB or NISH must ensure that they each have a workforce in which 75 percent or more of the direct labor hours during a fiscal year are performed by people who are blind or severely disabled. Furthermore, it is the Committee for Purchase's policy that no less than 60 percent of direct labor hours for any given product or service must be performed by employees who are blind or have severe disabilities.

NIB and its associated industries serve a small and carefully circumscribed population. The JWOD Act defines a person or persons with blindness as "an individual or class of individuals whose central visual acuity does not exceed 20/200 in the better eye with correcting lenses or whose visual acuity, if better than 20/200, is accompanied by a limit to the field of vision in the better eye to such a degree that its widest diameter subtends an angle of no greater than 20 degrees." (41 U. S. C. @ 48b(1)) This precise definition does not rely on subjective determinations of ability.

Individuals who work for NIB associated industries can truly be considered "employees" rather than "clients." All NIB associated industries make FICA contributions, and employees of NIB associated industries rarely continue to receive daily living skills training, pre-vocational skills, "work adjustment" and other services.

WHAT IS NIB?

National Industries for the Blind is a private not-for-profit corporation whose mission is to create high quality employment opportunities for people who are blind. Agencies serving people who are blind created and funded NIB to act as their liaison with the JWOD program. NIB works with 121 nonprofit associated industries in 40 states, Puerto Rico, and the District of Columbia. Industries associated with NIB provide jobs to more than 5,300 people who are blind, 40 percent of whom have multiple disabilities and 43 percent of whom are from minority populations.

NIB has been providing quality products to the federal government for almost 60 years. You may be familiar with two of our most popular products; ballpoint pens and paper writing pads, or with our trade name SKILCRAFT®. Our strategy for the future includes plans to diversify the variety of career choices within our industries. We are moving toward more computer based jobs and continue to enter into public/private partnerships with small and large businesses to achieve mutually beneficial goals.

NIB'S TRACK RECORD

In 1995, more than 5,300 blind employees of NIB associated industries received approximately $50 million in wages and fringe benefits, while producing over 1,800 products and services for the Federal Government. We are particularly proud of the nearly $14 million in benefits paid to employees who are blind. Benefit packages, including health care and retirement, are routinely offered. Benefits paid in 1995 amounted to approximately 39.5 percent of payroll, exceeding such percentages among like industries in the private for-profit sector.

As a result of vocational training provided by NIB associated industries, over 1,600 individuals obtained employment in their communities. NIB associated industries also provided a variety of rehabilitation services to more than 128,000 children and adults, including early childhood intervention, training in use of the long white cane and other orientation and mobility skills, low vision evaluation, computer and Braille literacy, vocational evaluation, and more.

As the service industry rapidly expands in the United States and new computer technologies continue to emerge, an increasing number of service-related employment opportunities are available through NIB associated industries. In addition to NIB's traditional manufacturing jobs, career choices in the service arena currently include medical transcription, telemarketing, order taking/order processing, data entry, warehousing and distribution, customer service, data base management, switchboard operations, mailing services and more.

This impressive array of career choices provides opportunities for people who are blind to obtain valuable training, skills and experience, empowering them, if they so choose, to compete for jobs in the private for-profit sector on a more level playing field. Equally as impressive, however, is that these new service jobs are currently paying wages of $7 to $16 an hour, plus benefits. NIB's goal is to convert at least 25 percent of all positions offered by its associated industries to such service-related jobs for people who are blind by the year 2000.

JWOD SAVES TAX DOLLARS

NIB recently commissioned the respected firm of Wertheimer Economic Associates, Inc. to conduct a cost and benefit analysis of the JWOD Program. The study confirmed that the JWOD Program is a sound investment for the Federal Government. In estimating the benefits in 1994, from a Federal budgetary perspective, the study found:

> JWOD participants (employees) earned between $95.4 and $102.7 million more than they would have earned in the absence of the program.
>
> JWOD participants contributed to a total increase in taxes paid (income, Medicare, and Social Security) of a net range between $17.6 and $18.9 million.

In addition, transfer payments such as Supplemental Security Income, Food Stamps, and Aid to Families with Dependent Children, decreased between $35.5 and $40.5 million.

In estimating the costs, from a Federal budgetary perspective, the Wertheimer study found the costs in 1994 to equal approximately $33.4 million. Based on these findings, the study estimated the Federal Budget benefit/cost ratio to lie between $1.59 and $1.78 to $1.00. The JWOD program produces this savings while impacting on less than one half of one percent of total federal government procurement.

NIB BUILDS PARTNERSHIPS WITH BUSINESS

In addition to its success in providing employment opportunities while saving tax dollars, the JWOD program has been designed to allow for maximum flexibility in balancing the interests of small business with the authorized responsibilities of NIB and NISH. NIB's practice is to cooperate with for-profit businesses in accomplishment of its mission, and we have given up or limited the performance of some contracts to accommodate the concerns of small business.

Additionally, NIB associated industries continue to partner with small and large businesses to achieve mutually beneficial objectives, and our on-going working relationship with Valley Forge Flag Company is an example of such partnerships. Three NIB associated industries have purchased raw materials and components from Valley Forge Flag Company in the past, and Blind Association of Western New York (BAWNY) in Buffalo continues to buy components from Valley Forge Flag Company today. Materials purchased by BAWNY amount to about $75,000 in sales to Valley Forge annually.

These cooperative relationships create a "win win" solution for all parties with an interest in doing business--small businesses, NIB associated industries, and, most importantly, our employees who are blind. NIB is committed to developing strong and long-lasting relationships with commercial business. We intend to build on our successes, using our outstanding relationships with businesses such as the 3M Corporation and Boeing Aircraft Corporation, as models of the direction in which we intend to take our program.

Working in conjunction with 3M, NIB associated industries are producing many useful quality products including Post-It Pads, Telephone Message Pads, Surgical Masks, Safety Vests and Belts, Diskettes, First-Aid Kits, Scotch Color Film, Video cassettes, Transparencies and more. Producing these products alone allows NIB to employ over 60 people who are blind.

At the Lighthouse for the Blind, Seattle, Washington, employees who are blind, many of whom have additional disabilities, are working on subcontracts for Boeing Aircraft Corporation. For example, employees use shears or table saws to cut pieces of aluminum to length. Tracer mills are used to make duplicate designs and parts from a pattern. The Lighthouse's subcontract work for Boeing provides employment for 60 to 80 individuals.

Where commercial firms would look for ways to eliminate labor and streamline labor costs, NIB associated industries are committed to maximizing employment for people who are blind. We are willing to discuss possible subcontracting work with any business at any time to accomplish this objective, and we will continue to work cooperatively with the for-profit community to fulfill our mission.

ASSERTIONS vs. FACTS ABOUT JWOD

The JWOD program, NIB's role in the program, and the unique needs of people who are blind or who have severe disabilities, can be complex. Also, a general lack of knowledge about our work perpetuates misconceptions about the program. Below, we answer some of the specific issues raised as objections to JWOD. Please note that all references are to written statements submitted for the record.

Assertion:

"With the creation of the Americans with Disabilities Act and the change in attitude which it reflects, the JWOD Act is no longer needed."

---Philip C. Hanson, The C. H. Hanson Company

Fact:

The Americans with Disabilities Act (ADA) is a landmark achievement in the struggle to unequivocally establish the civil rights of people with disabilities. However, enactment of the ADA is not a panacea for all of the challenges confronted by people with disabilities, and its mere enactment does not, in itself, wipe away centuries of discrimination and doubt about the capabilities of people who are blind.

Although the ADA has already begun to bear fruit for people with disabilities generally, recent statistics reported by the American Foundation for the Blind indicate that the jobless rate among people who are blind is 74 percent, a slight increase over percentages reported prior to the ADA's enactment. In light of this persisting inequity, America's disability policy cannot turn its back on programs, such as JWOD, that provide meaningful opportunities for employment.

Moreover, the JWOD program is designed to meet the needs of a limited population of people with severe disabilities as specified by the JWOD Act and regulations. Typically, in order for people with disabilities to be counted as part of the workforce on JWOD contracts, they must not yet be ready to engage in so-called normal, competitive employment. Although all people with disabilities, but for discrimination, may have the potential to obtain and retain work, many people who are blind or severely disabled often lack the skills and experience so frequently sought after by the private for-profit sector. JWOD fills that void by providing training and employment.

Assertion:

"The majority of persons placed in these segregated versions of disability-based child labor sweat shops never leave. They stay there and make an average of .25 per hour."

---Robert P. Stack, President/CEO, Community Options, Inc.

Fact:

In 1995, the average hourly wage of people who are blind employed by NIB associated industries was $5.30. When taking benefits into account, including medical coverage, the average hourly wage was $7.39. Furthermore, as indicated above, many jobs in the service arena are paying much higher wages, from $7 to $16 per hour.

Fringe benefits, routinely offered by NIB associated industries, rival, and often exceed, those offered to employees in the private sector. Additionally, our associated industries often provide such services as transportation (to and from work or to medical appointments), counseling, literacy skills and more.

Assertion:

"The persons generally stack and string and sort objects; they do meaningless work, and they are stuck in an environment controlled by persons who have a vested interest in them staying there with no chance of getting out."

Robert P. Stack, President/CEO, Community Options, Inc.

Fact:

A wide range of employment options are available through NIB associated industries. Manufacturing operations typically include sewing, hand assembly, molding, packaging, thermoforming, shrink wrapping, mechanical assembly, silk screening, and machining & fabrication. Employment options in the service area include medical transcription, telemarketing, data entry, customer service, and other administrative support positions.

Additionally, opportunities abound for people who are blind, who so choose, to use NIB associated industries as a stepping stone to employment in the community. As a result of employment and vocational training provided by NIB associated industries, over 1,600 individuals obtained employment in their communities in 1995 alone.

Finally, job satisfaction is high among the employees of our associated industries. An independent survey of direct labor employees conducted by Mississippi State University found that over 60 percent of the entire direct labor workforce expressed overall satisfaction with their jobs, easily rivaling the private for-profit sector.

Assertion:

"The administration of the JWOD program is riddled with conflicts of interest. There is no oversight and no accountability."

---Michael Liberman, President, Valley Forge Flag Company

Fact:

A system of checks and balances exists to continuously monitor and upgrade the effectiveness of the program. Some of the major institutional checks on the JWOD program include:

1. Congressional Oversight: Annually, Congress holds appropriations hearings on the Committee for Purchase and receives a detailed report of JWOD accomplishments. Throughout its history, the program has periodically been the subject of oversight hearings by Congress.

2. Strict Compliance with Federal Law: In addition to compliance with the JWOD statute and regulations, industries must comply with the Fair Labor Standards Act, Service Contract Act, OSHA, and other Federal and State laws, and submit to on-going compliance or inspection visits by Committee for Purchase staff, Department of Labor Wage and Hour personnel, NIB and NISH compliance officials, OSHA inspectors and others.

3. Committee for Purchase Oversight of NIB: Committee members are appointed by the President of the United States and include representatives of Federal agencies and knowledgeable individuals from the private sector. NIB and its associated industries must abide by detailed regulations adopted by the Committee. In addition, NIB annually submits a report of planned activities to the Committee prior to the start of the fiscal year, and a report of accomplishments at the end of the year, followed by formal presentations.

4. NIB's Structure: Incorporated in New York State as a private, not-for-profit organization, NIB is subject to very rigorous rules and restrictions placed upon such entities. Additionally, members of NIB's Board of Directors include prominent representatives of the business community and the field of blindness, ensuring responsiveness to the for-profit sector and the interests of people who are blind.

Assertion:

"Fortunately, several easy fixes are available. The most obvious option would be to simply repeal the JWOD Act in its entirety."

---Philip C. Hanson, The C. H. Hanson Company

Fact:

Repealing the JWOD Act would be unconscionable. Such an action would result in the loss of employment for thousands of people who are blind or severely disabled, a population whose employment options have long been, and continue to be, restricted by prejudice.

The JWOD program accomplishes its objectives while possessing the flexibility required to be sensitive to the interests of the for-profit business community, and NIB's record of successes and our continued effort to work in tandem with small and large businesses demonstrates this flexibility.

CONCLUSION

As outlined throughout this statement, JWOD is a cost-effective method for eliminating joblessness among people who are blind or have severe disabilities. It is a shining example of public-private partnership, and it is sensitive to the concerns of for-profit business. Most significantly, JWOD empowers people with disabilities to lead productive and independent lives.

Goodwill Industries and the For-Profit Small Business Sector:

AN ANALYSIS OF ALLEGATIONS OF "UNFAIR" COMPETITION

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GOODWILL INDUSTRIES AND THE FOR-PROFIT SMALL BUSINESS SECTOR: AN ANALYSIS OF ALLEGATIONS OF "UNFAIR" COMPETITION

I. Introduction

Goodwill Industries is the world's largest network of autonomous, nonprofit organizations (exempt from federal taxation under Section 501(c)(3) of the Internal Revenue Code of 1986) providing vocational services and employment for individuals with special needs. Within the large and diverse tax-exempt sector, Goodwill Industries is unique in that its operations and activities are designed to foster employment, thereby leading to the resultant economic and social independence for people who, for a variety of reasons, are unable to obtain or retain work in the competitive labor force. The "vocationally disadvantaging" conditions that restrict employment opportunities for individuals served by Goodwill Industries may result from a lack of education or marketable job skills, physical or mental disabilities or changing economic conditions (e.g., corporate "downsizing").

Goodwill Industries' primary goal is to provide these individuals with a structured program of vocational rehabilitation and job training within a facility- or community-based environment, ultimately leading to unsubsidized employment. In its efforts to provide realistic job-training experience, Goodwill Industries engages in activities that, at first glance, may seem indistinguishable from those undertaken by for-profit entities. While Goodwill Industries is best known for the collection and resale of donated household items in its thrift stores, industrial and commercial contracts for the production of goods and the provision of services for federal/state/local governments

and the for-profit sector are also performed. Goodwill Industries readily recognizes that, in certain markets and product lines, it appears to compete directly with limited portions of the for-profit sector, often with entities considered to be small businesses. The key question, however, is whether Goodwill Industries' tax-exempt status allows it to compete "unfairly" with the for-profit small business sector.

Allegations of unfair competition between the tax-exempt and for-profit sectors are not new. Complaints that tax-exempt organizations were engaging in activities that strayed from their charitable missions led, in 1954, to enactment of a federal tax on income deemed to be substantially unrelated to an organization's exempt purpose. In 1986, delegates to a White House Conference on Small Business voted unfair competition from nonprofit organizations as the third most important issue confronting their sector. The priority placed on the issue by the White House Conference led the following year to an intensive inquiry into the revenue-generating activities of tax-exempt organizations by a House of Representatives Ways and Means subcommittee. Although a variety of restrictions were proposed by the Ways and Means panel to limit certain tax-exempt organizations' operations, after thorough debate and careful consideration none were enacted into law.

In 1987 Goodwill Industries contracted with the Santa Fe Corporation to study issues concerning unfair competition. As published, that study concluded that Goodwill contributes to the tax base of the United States, and that its human services ". . . not only have a tremendous social, but also a very significant economic impact which more than

compensates for the federal income tax which Goodwill would otherwise pay."[1] In 1994, a subcommittee of the House of Representatives Committee on Small Business, at the request of certain small businesses, conducted a series of hearings into unfair competition allegations. Again, a number of restrictions on tax-exempt organizations' activities were discussed by the subcommittee, but no legislative proposal was introduced.

Historically, Goodwill Industries has enjoyed a mutually beneficial relationship with the small business sector. As a source of trained, motivated workers, Goodwill Industries directly reduces the costs to small businesses of recruitment and training of their employees. Small businesses are also a source of industrial and commercial contracts used to generate revenue to support realistic job-training programs. In addition, representatives of small businesses provide valuable expertise that directly contributes to the success of Goodwill Industries through their service on Goodwill boards of directors and advisory committees.

The 1987 Santa Fe study concluded that allegations of unfair competition, when applied to Goodwill's operations, were not substantiated. This analysis is intended to re-examine this issue to determine if, in the intervening years, Goodwill Industries' operations have changed to an extent that would validate the small business sector's concerns. In view of the close relationship between small businesses and Goodwill Industries, such a conclusion would necessitate a re-examination of how Goodwill pursues its charitable mission.

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[1] *Evaluating the Issue of Alleged Unfair Business Competition Between Goodwill Industries and the For-Profit Commercial Sector*, prepared for Goodwill Industries of America, Inc. by Santa Fe Corporation (Bethesda, MD: Goodwill Industries of America, Inc., April 1987), p. 30.

In 1994 Goodwill Industries of America changed its name to Goodwill Industries International, Inc. to reflect its relationship with not only 183 member organizations in the United States, Guam, American Samoa, and Canada but also with 49 affiliates throughout the world.

II. Unfair Competition? Allegations and Rejoinders[2]

Representatives of small businesses have become increasingly agitated by, and actively opposed to, perceived competition with their businesses provided by governmental entities and nonprofits. Small business advocates say the tax-exempt sector has changed in character. Because of cutbacks in governmental funding for social services, the enormous growth in the number of tax-exempt organizations competing against each other for scarce funds, and the reduced tax incentives for charitable deductions, the tax-exempt sector no longer relies primarily on donations and grants for its income. Instead, they say, the sale of goods and services to others is now the primary source of income for nonprofit groups. Certain small business representatives claim that it is these goods and services provided in competition with those sold by for-profit businesses that create unfair competition.

Nonprofit organizations respond that it is for-profit businesses that have moved into the nonprofits' arenas of service, not nonprofits moving into areas of for-profit business activity, that have produced the existing competition. Noting that the number of for-profit social service organizations increased 86 percent and their revenues 92 percent between 1977 and 1987, William M. Brodhead writes, "For-profit businesses which provide social services may serve the public good, but their principal purpose is to

[2] The statements in this section of the paper are an amalgam of arguments presented by advocates for small businesses and advocates for nonprofits.

Clear statements of the positions of small business advocates can be found in various publications of the Business Coalition for Fair Competition (BCFC) of Washington, D.C., an alliance of for-profits founded in 1983 to lobby against competition with small businesses by nonprofits and governmental agencies. BCFC has been active in promoting its demands at both the state and federal levels.

make a profit."[3] Indeed, public policies have encouraged this movement by for-profits into nonprofit areas of service by allowing for-profits to compete for federal grants and contracts. Small business advocates say that the federal Unrelated Business Income Tax (UBIT), designed to tax nonprofit sales of goods and services that are not "substantially related" to tax-exempt purposes,[4] does not work.[5] As remedies to the alleged unworkability of UBIT and to the ongoing "unfair" competition, they suggest measures such as the following:

- Clarify and narrow what constitutes "substantially related" (and thus tax exempt) activities for nonprofit organizations.
- Tax "unrelated business income" at a rate high enough to discourage activities not related to exempt purpose.
- All nonprofit activities that are also offered by for-profits should be taxed.
- Tax-exempt organizations should not be allowed to conduct <u>any</u> so-called "commercial" activities that compete with for-profits. Exceptions, if any, must be priced to include the full costs for-profits bear in terms of taxes, etc.
- Level the playing field by ensuring that governmental contracting processes include full consideration of the taxes not paid by nonprofit organizations.

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[3]*Competition Between For-Profits and Nonprofits: What's Fair? What Serves the Public Good?* (Washington, D.C.: Independent Sector, 1988–revised 1994), pp. 2,4.

[4]Section 501(c)(3) of the Internal Revenue Code exempts from federal corporate income tax organizations organized exclusively for religious, charitable, scientific, literary, or educational purposes or to test for public safety, foster amateur sports competition, or prevent cruelty to children and animals.

[5]James D. Santini, Chairman, Business Coalition for Unfair Competition, explains why, in his view, UBIT does not work: "With such a subjective test ('relatedness') used for such subjective terms (e.g., 'educational'), and with very little IRS enforcement, it is not surprising that not much tax revenue comes to the Treasury from otherwise tax exempt organizations each year." Statement to the U.S. House of Representatives Committee on Small Business, Subcommittee on Procurement, Taxation, and Tourism, Hearings, June 16, 1994.

- Change laws in all states to require nonprofits to place all of their commercial activities under separate, for-profit subsidiaries.
- "Fair competition among organizations can be achieved when competitors are not advantaged by tax exemptions or governmental funding."[6]

In contrast, advocates for nonprofit groups claim that the UBIT works well. The UBIT test of whether income is "substantially related" to the charitable purposes of a nonprofit does distinguish it from activities carried on to make a profit. Furthermore, only a small portion of the $17 billion in nonprofit income from dues, fees, and charges is "unrelated business income" and, so, taxable. Any surpluses that do occur, including net income from unrelated income, are used to cover earlier deficits and to subsidize services to low-income clients.[7]

Nonprofit representatives point out the many positive contributions tax-exempt organizations make to American life. They aid the economic health of small businesses by encouraging new markets. They promote civic virtues of altruism and activism through citizens' donations of time, money and energy. Unlike for-profit entities, whose raison d'etre is to make a profit, it is claimed that the principal purpose of nonprofits is to provide "public good" that benefits American life. Principally this means making accessible, over the long-term, services that are needed or requested by diverse socio-economic groups that include the poor as well as the rich. Nonprofits' provision of these services is accountable to the public through the availability of Internal Revenue Service

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[6]Ibid.

[7]John Kemp, Executive Director, United Cerebral Palsy Associations, Testimony before U.S. House of Representatives Committee on Small Business Subcommittee on Procurement, Taxation, and Tourism, June 16, 1994.

(IRS) Form 990 reports on revenues and expenses, and through oversight of their boards of directors.

Small business advocates dispute some of these claims. They say that the public needs better access to nonprofits' Form 990s, and that nonprofits should be penalized for inaccuracies in their Form 990s. They contend the claim that nonprofit organizations offer special "public good" not offered by for-profits is not true for all tax-exempt groups. Because *some* nonprofits will not serve those who cannot pay, their work is no more "charitable" than that of for-profits. Despite the public's "halo effect" that assumes nonprofits offer a higher quality of services than do for-profits, there is no evidence, say small business advocates, that this is true.

Above all, say small business advocates, the competition is unfair because the playing field is not level: nonprofits receive public subsidies unavailable to for-profits. These include, but are not limited to, exemption from federal, state, and local taxes (corporate income, property, sales taxes); discounts on mailing costs; the use of free labor (volunteers); special exemptions from other requirements (e.g., federal unemployment insurance); the "halo effect"; and eligibility for public and private grants. Supporters of the small business position make this argument sound less self-serving and more public-spirited by pointing out that subsidies rob the public coffers.[8]

Nonprofit advocates respond that these complaints represent important misconceptions about the operations of the tax-exempt sector. In reality, charitable

[8]In June 1994 the office of Congressman Bilbray, chairman of the House Subcommittee on Procurement, Taxation, and Tourism, issued a statement announcing hearings on this matter and estimating that tax exemptions for nonprofits result in an annual loss of more than $36 billion in tax revenues.

organizations do not have an advantage.[9] Both nonprofits and for-profit businesses pay Social Security taxes for their employees, and most nonprofits either pay state unemployment taxes or self-insure to cover such costs. The employees of both types of enterprises pay personal income taxes. Indeed, most of the revenue to governments from human service organizations, whether for-profit or nonprofit, is from the personal income taxes of their employees. After including tax credits and deductions, most for-profits offering social services pay little or nothing in terms of corporate income taxes—only 0.26 percent of their gross receipts in 1982. Furthermore, in 1982 one-third of for-profit social service businesses' reported net income belonged to "Subchapter S" corporations, which are exempt from corporate income taxes. The *Myth of Unfair Competition* estimates that tax exemptions bring nonprofits an advantage over for-profits of less than 0.5 percent of their gross receipts.

Not only have nonprofits defended themselves in the ways described above, but they have also mounted a more activist challenge to unfair competition allegations. They note the many tax and public policy advantages enjoyed by for-profits are not available to tax-exempt organizations. These include:

- A federal agency, the Small Business Administration (SBA), exists to advance the well-being of the small business sector.
- Small businesses incorporated under Subchapter S are exempted from paying federal corporate income taxes.

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[9]The following arguments and 1982 data come from Harrison Wellford and Janne G. Gallagher, *The Myth of Unfair Competition by Nonprofit Organizations: A Review of Government Assistance to Small Business*, A Report to Family Service America and The National Assembly (N.p.: October 1985).

- A substantial portion of federal procurement contracts for goods and services are specifically "set aside" for small businesses. (While nonprofit vocational rehabilitation facilities have, at times [i.e., Fiscal Year 1995], been eligible to compete for set-aside contracts, awards have been negligible.)

- There are technical assistance programs available to management, etc. that are exclusively available to small businesses.

- For-profit entities are given tax credits, tax deductions, and depreciation allowances—some for more than their actual costs—in order to subsidize their work.

Lastly, if the competition between for-profits and nonprofits is unfair, in what ways is this so and unfair to whom? To businesses wanting to make profits? To nonprofits finding their traditional areas of service increasingly encroached upon by for-profits? To consumers choosing goods and services? To the individuals served by nonprofits? One nonprofit leader put it this way: "The problem is not unfair competition. The problem is competition, period. The small businesses don't want any."[10]

How, then, can we assess these arguments?[11] In the following pages, attention will focus on the activities of one charitable organization—Goodwill Industries—and how it relates to allegations of unfair competition. We shall then offer some recent empirical evidence concerning the activities of for-profit enterprises.

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[10]Garris Distelhorst quoted in "The Debate Over Competition Between For-Profits and Tax-Exempts: Oversight Hearings Previewed," Tax Notes, June 15, 1987, p. 1049.

[11]Jeffrey R. Haber writes that the two sides of this debate have not yet agreed on what the questions are. How does one decide whether competition exists? Will the existence of competition be decided on an industrial or individual company basis? What do we mean by "unfair"? What are the criteria for a "small business"? "Nonprofit Competition with Small Business: A Roadmap Leading to Answers," *Nonprofit World*, May/June 1994, pp. 14-18.

III. The Activities of Goodwill Industries: Promotion of the Public Good

Continuity and Change over Time

Goodwill Industries began at the turn of the century when a Methodist minister started a program of donated household goods, processing, resale, and wages in order to aid poverty-stricken immigrants.[12] This focus eventually changed to a concentration on those with physical disabilities and, later yet, those with a variety of disabilities including mental and emotional disorders. By 1985, persons with a variety of disabilities constituted about 90 percent of Goodwill's clientele.

In the late 1980s intense discussion among the autonomous member agencies that make up the Goodwill Industries network led to a recognition that their real charitable mission is to serve an array of groups needing vocational services, rather than a specific population (such as people with disabilities). This understanding, along with employers' proclaimed needs for skilled workers, led Goodwill to serve proportionately more of those who are "vocationally disadvantaged" (those with limited access to employment and other resources unless there is intervention and assistance). People who are vocationally disadvantaged (e.g., welfare recipients, chronically unemployed, ex-offenders, etc.), now constitute the largest grouping of Goodwill clients—47.5 percent in 1994.

Today Goodwill Industries is the largest employer in the world of people with disabilities or vocational disadvantages and the world's largest network of private, nonprofit agencies providing vocational services to such individuals. Its statement of

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[12]The following relies on David M. Cooney, "Goodwill Responds to Needs—Not Just Populations," *Rehab USA*, Spring 1991, pp. 11-14.

mission reads:

> Goodwill Industries will actively strive to achieve the full participation in society of people with disabilities and other individuals with special needs by expanding their opportunities and occupational capabilities through a network of autonomous, nonprofit, community-based organizations providing services throughout the world in response to local needs.

Over time, not only have the groups served by member Goodwills broadened in character, but also Goodwill activities have themselves changed. A plethora of vocational services to meet a variety of needs, an emphasis on retail and contract work to provide training and employment for clients and income for vocational rehabilitation, the expansion into all regions of the United States and to other parts of the world. Goodwill states its philosophy in this way:

> . . . Without the power and dignity of work, and its derivative economic power, individuals are diminished in virtually all aspects of social interaction and life. Goodwill recognizes the complex relationship of work to self-esteem, and seeks to provide the people it serves with opportunities to control their own lives effectively while becoming positive, functional, interdependent members of the community.

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How Goodwills Serve the Vocationally Most Vulnerable: People Who Are Disadvantaged or Disabled[13]

If we classify the people served by Goodwills in 1993 according to their primary vocational handicap, those with disadvantages were the largest grouping (45 percent).[14] The second largest grouping were those with mental retardation (16 percent). Among others served, the primary obstacle to employment was mental illness and/or behavioral problems (12 percent); other orthopedic deformities (6 percent); and other disabling medical, learning disability, or chemical dependency conditions (5 percent).

Goodwill clients are from a variety of ethnic backgrounds (54 percent white, 43 percent black, 11 percent Hispanic). The great majority (77 percent) are between 17 and 44 years old.

Given the clients' varied backgrounds and vocationally disadvantaging conditions, Goodwill Industries faces a major task in building competence and confidence in the people served. It is recognized that clients' difficulties may present special hardships for them in terms of learning, emotions or physical functions. Therefore, different kinds of treatments and of supervision are needed; and effective vocational rehabilitation may require some built-in inefficiencies. Goodwill Industries' *A Guide to Vocationally*

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[13]Unless otherwise noted, statistical information in the following sections comes from Goodwill Industries' *1993 Statistical Report*. (Bethesda, MD: Goodwill Industries International, Inc., March 1994). The *1993 Statistical Report* surveys 171 member Goodwills in the United States, one in American Samoa, one in Guam, and six in Canada. Because not every Goodwill surveyed answered every question, totals for all 179 are "projected" through extrapolation based on those answering each question.

[14]This grouping is made up of a variety of statuses: 25 percent welfare recipients, 20 percent dislocated workers, 16 percent youth at-risk, 10 percent long-term unemployed, 9 percent chronically poor, 7 percent ex-offenders, and 13 percent all others.

Disadvantaging Conditions[15] sets forth numerous disabilities and disadvantages and ways to alleviate them. For example, a reliable man who has a learning disability in terms of counting and writing can still function adequately as a dock supervisor at a member Goodwill, if Goodwill makes appropriate accommodations: using drawings where he can mark down numbers of items received and letting him dictate to a secretary, rather than writing, his impressions of the trainees he is supervising. His desire to improve his academic skills is encouraged by allowing him early leave several days a week to attend Goodwill's GED classes.

Another deliberate inefficiency concerns Goodwill physical facilities, which are modest but more spacious than strict efficiency would mandate. As a Goodwill Industries internal document states:

> If Goodwills, since their inception, would have been only profit-motivated, Goodwills over the years would have become significantly different from the Goodwills that we know today. Their buildings would be smaller, more cost-effective, making greater utilization of space; many of its operations would be automated with fewer jobs. Its work force would be more organized to yield more productivity. Its management and supervisory structure would be thinner, more singly objective motivated [namely, to make profits] and less lenient.[16]

In 1993 an estimated 123,176 different individuals were served by the 179 Goodwills surveyed, and many individuals received more than one service. In descending order the programs in greatest demand were: job placement, vocational evaluation, job-search skills, vocational services, case management, work adjustment, skills training and sheltered employment.

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[15](Bethesda, MD: Goodwill Industries International, Inc., 1994).

[16]Lynn Joerger, "The Dilemma of Rehabilitation vs. Industrial Costs," undated.

In addition, Goodwill provided many ancillary services that supported its vocational services. Ancillary services were provided to the following proportions of clients served: medical and nursing (19 percent), social (15 percent), family support (9 percent), transportation (8.5 percent), residential (8 percent), psychological (4 percent), and all other (literacy training, day activity, rehabilitation engineering, etc.—24 percent).

Effects upon Consumers of Goodwill Programs

The statistics presented by Goodwill Industries of the effects of the many programs offered by member Goodwills illustrate only a fraction of the total picture. This is due to several factors: (1) member Goodwills do not expend resources on collecting data on clients' work lives after their initial placements by member Goodwills or after their departure from Goodwill programs; (2) referring agencies order placement services by Goodwills in only 21 percent of the cases; (3) agencies referring clients to Goodwills for vocational rehabilitation may themselves make placements, or other dispositions, for clients. These positive outcomes would not appear in Goodwill's annual statistical survey; (4) individuals receiving Goodwill services may go on to training school or to college or to work that they find—again, positive outcomes not statistically calculated in Goodwill's efforts.

Accordingly, the success of Goodwill vocational rehabilitation services cannot be measured solely by the number of immediate placements made by Goodwills. Many of Goodwill's efforts can better be interpreted as successful in helping a client overcome one or more obstacles on that individual's road toward employment. The appendix to

this paper contains three case studies, prepared by Goodwill Industries International staff, of the varying difficulties faced, and the personal and vocational growth achieved by these individuals served by member Goodwills.

Supplementing Goodwill's vocational rehabilitation programs are opportunities for additional training and work experience through its retail and contracts operations. Those needing longer training and preparation for work may enter "sheltered" employment at Goodwill Industries, or participate in "supported" employment programs, where Goodwill provides the required services for an individual to benefit from a community-based employment setting. They may assist with goods and services furnished under contract between Goodwill and outside vendors, or with Goodwill's donated goods program in the collection, processing and sale through retail stores of contributed household items (a revenue generating activity used since Goodwill's inception). In 1993, 44 percent of all Goodwill employees were "clients" (that is, those receiving Goodwill vocational services).

Under provisions of the Fair Labor Standards Act (FLSA), individuals with disabilities for whom placement in the competitive labor force is not a realistic expectation based on present level of performance/productivity may be paid special minimum wages. Under Section 14(c) of the FLSA, these individuals are paid wages commensurate with similar work in the community, but based on individual productivity. For example, if a job in a community typically pays $8 per hour, a Goodwill client whose productivity is rated at 50 percent may be compensated at $4 per hour. Individuals paid under Section 14(c) are afforded certain protections, including a requirement that

productivity be measured regularly and the right to appeal wage determinations to the United States Department of Labor. Therefore, under these longer training periods of sheltered or supported employment, clients experience the dignity of working and of earning a wage while improving their work skills and work behavior under Goodwill's trained supervision and support.

An outcome of Goodwill efforts with tremendous significance for individual lives and families is, then, the placement of clients into supported, sheltered, or competitive employment, the latter either within or outside Goodwill facilities. Many of those so placed would not have otherwise achieved employment because of their individual disadvantages and disabilities. Table No. 1 in the appendix enumerates the different kinds of placements and incomes for 1993. Goodwill Industries also employ in regular, competitive staff positions many individuals, most of them not former clients, who have physical, mental or emotional disabilities.

Some Broader Outcomes of Goodwill Services

Another important grouping of measurable outcomes of Goodwill services that promote the public good concerns the wages of clients placed in employment (generally entry-level positions), the wages of Goodwill employees and taxes paid. These amounts are shown in table 2 in the appendix. The same table demonstrates the cost-effective nature of Goodwill efforts: every $1 of public financial support for operations results in $11.58 in earnings for Goodwill clients and employees. For every $1 of rehabilitation funding (from governmental sources), $2.26 in new purchasing power results. Every $1

in rehabilitation funding generates $.34 in payroll taxes.

An additional grouping of positive outcomes resulting from Goodwill activities is the stimulation of civic activity, altruism, and community-building that occurs through heightened volunteerism.[17] Volunteers without remuneration serve Goodwills in a variety of capacities. Approximately 3,770 serve on boards of directors for local Goodwills. About 1,440 professionals serve on 54 local business advisory councils advising Goodwills on the training requirements to meet employers' hiring needs in their particular localities. In some areas Goodwills are facilitating the establishment of community advisory councils to work on problems of human services delivery (e.g, child care, transportation, etc.) common to agencies of that locality.

The largest formal group of Goodwill volunteers, GIVS (Goodwill Industries Volunteer Services), reports[18] that in 1993, 65 GIVS organizations with 9,691 members contributed an estimated 381,102 hours to support Goodwill's charitable mission. These efforts included fundraising for Goodwills through book sales, home tours, etc., and direct assistance to Goodwill clients (e.g., tutoring, transportation). In addition, GIVS volunteers raised over $1,348,297 in cash and equipment for local Goodwills, and community volunteers other than GIVS members contributed approximately 186,106

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[17]Some of the advocates of small businesses in the debate over unfair competition lambaste the availability of "free labor" (namely volunteers) for nonprofits and the "halo effect" given by the public to nonprofit services. These criticisms seem to dismiss benefits other than the economic "bottom line."

A substantial amount of the volunteer work and financial gifts to nonprofits stems from a hope that it is possible, and a belief that it is good, to help make life better for others. It is, not surprisingly, most rewarding to work for such goals in an environment sharing and supporting the goals (that is, nonprofits) rather than an environment fixated on making as much money as possible.

[18]GIVS information comes from Goodwill Industries Volunteer Services 1994 Annual Report (N.p.: reprinted June 1994).

hours of service in 1993, evaluated minimally at $790,951.

The largest grouping of volunteers is, of course, members of the public. In 1993 an estimated 21,500,000 people donated materials to Goodwill, including 694,000,000 pounds of textiles. The revenue generated from these donations provide funds for vocational rehabilitation and training programs, and for employment opportunities for Goodwill clients in transporting, processing and retailing the donated goods. This public participation assists in protecting the environment by keeping used goods out of the waste stream.

Resources for Providing Goodwill Services

In addition to the volunteerism and public support discussed above, fees for service, retail operations, and contracts for goods and services provide income to support Goodwill Industries programs. Because fees for service provided by federal/state/local sources do not cover the full cost of Goodwill's programs, revenue earned through retailing and contracting are essential to subsidize the vocational rehabilitation and other services provided to clients. In effect, by subsidizing the delivery of social services for which the government (and the public) has determined a need, Goodwills contribute an indirect form of taxation.

Governmental agencies are the primary referral route between clients and Goodwill programs. In 1993 about 34 percent came from state vocational rehabilitation agencies, 19 percent from public aid offices, and 13 percent from agencies administering federal Job Training Partnership Act programs. Other sources, each referring about 4

percent of eligible clients, include schools, mental health and retardation agencies, and private payers.

In 1993 Goodwill Industries revenues, as projected for 179 Goodwills, came from the following: 50 percent retail; 19 percent contracts; 19 percent fee payments (largely governmental) for rehabilitation services; 5 percent public support; 5 percent from salvage donated by the public; and 3 percent other.

Retail Operations. At the end of 1993 there were 21,282 Goodwill employees directly involved in retail operations for the 1,427 Goodwill stores. Twenty percent of these 21,282 employees were involved in collecting donated goods; 34 percent in processing the donated goods and readying them for resale; and 46 percent in the retail sales activities. Almost one-half of the employees in retail operations were client employees or employees with disabilities.

On average, hourly costs (direct and indirect) in the retail operations totalled $9.33, while generating $12.97 in revenues. While very beneficial to Goodwill activities in terms of this income, Goodwill retail operations are only a minuscule part of the overall retail picture—Goodwill's share of general merchandise sales in cities is less than 0.4 percent.

Contract Operations. Goodwills' contracts to provide goods and services to governments and to private businesses have increased in recent years, by 1993 constituting almost 19 percent of revenue. Nearly 20,000 job opportunities were created through these contracts in 1993.

Almost 90 percent of the contracts, but only 42 percent of contract revenues,

came from jobs based inside Goodwill facilities, such as packaging, packing, assembling and disassembling. Of the direct labor positions involved, 87 percent were directly assigned to Goodwill employees with disabling/disadvantaging conditions.

As for "community-based" contracts where the work is performed outside the Goodwill facility, in 1993 almost three out of every four such positions were assigned to clients or employees with disabilities. Like the retail operations, contract operations brought in revenue that remunerated direct labor employees and subsidized vocational rehabilitation and training programs—average cost per hour (direct and indirect) was $9.51 compared to revenue of $9.60.

In terms of revenues, the major types of community-based contracting were janitorial (61 percent), stocking of shelves (12 percent) and groundskeeping (5 percent). Governmental agencies—local, state, federal—are the main offerer for these community-based jobs. In all, 34 percent of these contracts were obtained through NISH.[19]

Decisions to seek or expand contract work at Goodwill Industries is not based on the availability of work or the need for revenue. Instead, "[Charitable] mission should drive the work that is obtained and define what should be kept . . . . The expansion of contract work should be based . . . on the needs of people served and on employment

[19]NISH (formerly National Industries for the Severely Handicapped) is a nonprofit agency established by federal law (the Javits-Wagner-O'Day Act) to administer a special federal procurement program giving preferential treatment to workshops serving people with severe disabilities. Such special procurement opportunities exist only when NISH determines that the nonprofit price is fair and there is no severe economic hardship to for-profit contractors. To compete within the NISH program, sheltered workshops such as member Goodwills must: a) be able to certify that at least three-fourths of the direct labor under contract is performed by people with severe disabilities; and b) pay a fee of 4 percent of contract revenue to NISH.

and placement opportunities within the community."[20]

Conclusions: Can Goodwill's Efforts Best Be Seen as Public Good or Unfair Competition?

It is often difficult to separate rhetoric and reality. Formally, by law, charitable assets must be used for charitable purposes. Surpluses of tax-exempt organizations, if any, must be utilized for the public good, not private benefit or inurement. As a condition of tax-exempt status, these groups are required to be under the effective governance of independent boards of directors.

How does one know whether these are merely formal statements or operating realities? In this case, the Goodwill Industries network is not only one of the nation's largest charities, it is considered by a variety of measures to be one of the best. Based on 1993 data for charities receiving 10 percent or more of their revenues from the public, *The NonProfit Times* ranks Goodwill as the fifth largest in terms of income.[21] Table 3 in the appendix compares various categories of Goodwill's income and expenses to the average of the 100 largest charities operating in the United States

Using this data, *Money* magazine ranks these 100 charities according to the percentage of income spent on programs during the last three years and whether they meet the strict standards of the two major watchdog groups for charities—the Council of Better Business Bureaus and the National Charities Information Bureau. Among social

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[20]"Advancing the Goodwill Mission Through Industrial Contracting," *Goodwill Forum*, Vol. 8, No. 8, 1994, p. 8.

[21]John McIlquham, "The Making of the 100," *The NonProfit Times*, November 1994, pp. 23-31.

services charities, Goodwill is ranked as 10th out of 32, meeting the standards of the charity watchdog groups, spending 83.7 percent of its income on program, and acting as the "largest private United States employer of the disabled: 56,387 of 94,621 staff."[22]

In addition, we know that the American public highly respects the work of member Goodwills. A recent poll for *The Chronicle of Philanthropy* ranks Goodwill among the most respected of charities. Goodwill places as 20th on the "best liked" list, mentioned by 32 percent of respondents; 16th on the "most credible" list, mentioned by 48 percent; 4th on the list of "most frequently donated to," mentioned by 24 percent; and 14th on the "strongly supported" list, mentioned by 72 percent.[23] And, as we earlier noted, an estimated 21.5 million people act on their statements of support by donating materials to Goodwill Industries.

Whether competition is considered fair or unfair appears to depend largely on economic self-interest, rather than on an objective examination of the contributions to the public good realized, the primary rationale for the creation and support of a tax-exempt sector. It seems clear, however, that Goodwills Industries do provide services, resources, encouragement, and ideals that enhance the public good in the communities in which they operate. And the public recognizes this fact, as do the charity watchdogs.

If it is desirable to build a democratic society based on values of civility, community and responsibility, then citizens must have ways to actively participate in good

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[22]Ellen Stark and Susan Berger, "The Top U.S. Charities," *Money*, December 1994, p. 161.

[23]Vince Stehle, "The Charities Americans Like Most--and Least," *The Chronicle of Philanthropy*, December 13, 1994, pp. 1, 12-14.

works and to empower people in need. Charitable organizations such as Goodwill Industries are vital to such an effort: participating in good works and empowering people in need is their work; they form a key link between individuals and the larger society, between localities and the nation.

IV. For-Profit Enterprises: Issues of Competition and Fairness

Issues of Competition

American governments—at the federal, state, and local levels—provide incentives for the success of for-profit businesses as well as nonprofits. Through the 1986 Tax Reform Act, major changes in the American tax code occurred.[24] The tax base was broadened, but overall taxes for individuals and corporations were lowered. While top marginal tax rates decreased for both individuals (from 50 percent to 28 percent) and corporations (from 46 percent to 34 percent), the lower rate established was for individuals' taxation (6 percentage points less than the rate for corporations), making it attractive for Subchapter C corporations paying corporate income taxes to reorganize as proprietorships, partnerships or Subchapter S corporations—all of which are taxed only at the individual (owners') level.

Thus, the number of Subchapter S corporations (which are typically small businesses because an S corporation can have only 35 or fewer shareholders, none of

[24]The following relies on the assessment of Tom Petska, "The Effects of Tax Reform on the Structure of U.S. Business," *Turning Administrative Systems Into Information Systems 1993*, eds. Bettye Jamerson and Wendy Alvey, U.S. Internal Revenue Service Methodology Report Series, (Washington, D.C.: U.S. Internal Revenue Service, March 1994), pp. 37-43.

them corporations, and one class of stock) increased, while the number of non-S corporations decreased. In 1991, 45 percent of all corporate tax returns came from S corporations which, like nonprofits, pay no corporate income tax.[25] Still, non-S corporations continue to dominate the financial activities of corporations: Subchapter S corporation profits—net income less expenses—in each of the years 1988, 1989 and 1990 were less than 9 percent of all corporate profits.[26] The 1993 Omnibus Budget Reconciliation Act increased top corporate income tax rates, but specific effects are not yet available.

Table 4 in the appendix shows IRS projections for all corporations in 1991 and 1992. All corporations combined (Subchapter S and non-S corporations) reveals that the corporate income taxes paid to the federal government are less than 1 percent of corporate revenues. This appears to be a less than impressive rationale on which to base allegations that "unfair" competition is a direct result of the tax-exempt status enjoyed by charitable organizations.

Table 5 in the appendix details for-profits' corporate tax returns in 1990 and 1991 for Minor Industrial Code 8300, Social Services. All of the for-profits in Code 8300 submitting federal tax returns in 1991 may be considered to be "small businesses" in that they each report total assets of less than $5 million.[27] In 1990, only 37 percent of the

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[25]Allison Clark and Patrice Treubert, "Corporation Income Tax Returns, 1991," U.S. Internal Revenue Service, *Statistics of Income Bulletin*, Summer 1994, p. 15.

[26] See Thomas B. Petska and Robert A. Wilson, "Trends in Business Structure and Activity, 1980-1990," *Statistics of Income Bulletin*, Spring 1994, pp. 27-72.

[27]U.S. Internal Revenue Service, *Source Book 1991–Statistics of Income: Corporation Income Tax Returns with Accounting Periods Ended July 1991-June 1992*, Washington, D.C., 1994, p. 472.

businesses sending in returns report any net income after expenses; net income taxes come to only 0.5 percent of total receipts. The comparable figure for 1991 was 0.6 percent. These calculations reconfirm the 1985 *Myth of Unfair Competition* conclusion that most for-profits offering social services pay little or nothing in terms of federal corporate income taxes—considerably less than 1 percent of receipts.

As tables 4 and 5 show, that businesses large and small benefit from generous deductions and tax credits that greatly lower the corporate income taxes payable to the federal government. It may be interesting to compare those two tables with table 6 offering federal tax information on Section 501(c)(3) organizations.

Besides these federal tax subsidies, for-profit enterprises reap many other advantages from the federal government. The SBA provides considerable assistance to for-profit small businesses.[28] In FY 1992, considered a lackluster year for the American economy and for small businesses, the SBA's assistance efforts included: $5.2 billion in credits for small businesses; $5 billion worth of contracting opportunities based on surety bond guarantees; $795 million in disaster loans; $618 million in Certified Development Company loans; $481 million invested through small business investment companies; $241 million in loans to small business exporters; and 403,818 individuals counselled concerning small business issues. Perhaps most importantly, $60 billion in federal procurement contracts (almost one-third of all federal contract and subcontract dollars) went to small businesses in FY 1992.

In FY 1991 all for-profits, regardless of size, were awarded 84.6 percent of federal

[28]The following information is from U.S. Small Business Administration, *SBA Fiscal Year 1992 Annual Report* (Washington, D.C.: n.d.), pp. 11-12.

contract dollars for contracts over $25,000, with small businesses getting 15.2 percent of the total and large businesses obtaining 69.4 percent. Nonprofit groups and educational institutions received only 4.2 percent of the federal contracts over $25,000. In contrast, contracts for less than $25,000 go predominantly to small rather than large businesses, with small businesses receiving 51.3 percent of total contract dollars for projects of $25,000 or less.[29] In FY 1991 the federal government exceeded its small business set-aside goals for prime contracts.

This analysis has focused on federal tax and policy incentives benefiting the small business and tax-exempt sectors because state (and, even more so, local) tax policies show a lot of variance from each other. However, some generalizations about the states can be made:

- States do offer some form of property and other tax exemptions to nonprofit groups.[30]
- The majority of states exempt from state sales taxes some or all purchases by charitable nonprofits, but they may differ on which categories of nonprofits they include as "charitable."
- Most states do not allow broad exemptions for sales by charitable, educational, or religious organizations; it is hard to predict how states will deal with these issues as nonprofits extend their services.[31]
- The Business Coalition for Fair Competition (BCFC) has been actively

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[29][U.S. Small Business Administration], *The State of Small Business: A Report of the President* (Washington, D.C., U.S. Government Printing Office, 1993), pp. 12, 296, 313, 359.

[30]For details see W. Harrison Wellford and Janne G. Gallagher, *Unfair Competition? The Challenge to Charitable Tax Exemption* (Washington, D.C.: The National Assembly of National Voluntary Health and Social Welfare Organizations, 1988).

[31]Janne G. Gallagher, *Sales Tax Exemptions for Charitable, Educational, and Religious Nonprofit Organizations*, A Special Report from the Human Services Forum of the National Assembly and Independent Sector (Washington, D.C.: September 1992).

working at the state level to develop legislation curtailing competition from governmental agencies or nonprofits. Some of BCFC's efforts have been successful; some have not.[32]

As discussed earlier, some representatives of the charitable sector charge that it is for-profits that are making the incursions into nonprofit territory. There is some evidence supporting this position. In Fiscal Year 1992 among the small business industries generating the most new jobs, the category of individual and family social services was seventh from the top with 232,000 new employees, an increase of 4.6 percent from the year before; the category of job training-vocational rehabilitation services was tenth from the top with 159,000 additional employees, an increase of 6.4 percent.[33] Furthermore, between 1987 and 1992 the number of for-profit job training/ vocational rehabilitation agencies increased from 26 percent to 30 percent of the total, and their revenues increased from 18 percent to 21 percent.[34]

V. Summary and Conclusions

It is often difficult to assess the various claims of the arguments over whether there is "unfair competition" between for-profits and nonprofits. Terms (such as "unfair") are not defined.

An examination of the activities of one charitable, tax-exempt organization—Goodwill Industries—demonstrates that:

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[32]See, for example, BCFC's *Unfair Competition in the States: How to Combat Competition from Nonprofit Business Ventures*, published 1985, and *State Legislatures Focus on Business Ventures of Nonprofits,* published 1989 (Washington, D.C.: Business Coalition for Fair Competition).

[33]U.S. Small Business Administration, *The State of Small Business*, pp. 57-58.

[34]Figures for 1987 are from Lester M. Salamon, *America's Nonprofit Sector: A Primer* (New York: The Foundation Center, [1992]), p. 84.

The figures for 1992 are calculated from U.S. Bureau of the Census, *1992 Census of Service Industries Geographical Area Studies: United States* (Washington, D.C.: December 1994), pp. US-12 and US-13.

- Time shows both continuity and change in Goodwill's activities. A plethora of services to meet a variety of needs, the use of retail and contract work to provide training for clients and income for vocational rehabilitation and the expansion throughout the United States and to other parts of the world. All are changes to meet the continuing needs of people for assistance in achieving work with dignity.

- Goodwill clients are primarily people with socioeconomic disadvantages, including physical or mental disabilities. Goodwill employees' work to build competence and confidence in clients is difficult and requires inherent inefficiencies.

- The success of Goodwill's rehabilitation efforts can be measured only in part by the number of clients immediately placed. Many of Goodwill's efforts can better be measured as success in helping a client overcome one or more obstacles on his or her road to employment.

- In addition to helping clients with vocational barriers, Goodwill employs in regular competitive staff positions many people who have disabilities.

- Goodwill's retail and contract operations are vital to its mission. They provide income to workers, provide additional job preparation and realistic training for clients and provide income to subsidize Goodwill's vocational rehabilitation services.

- Goodwill's efforts are cost-effective. Rehabilitation funding and public monetary support multiply the purchasing power of Goodwill clients and employees, and generate payroll taxes.

- Goodwill's work spurs volunteerism which stimulates civic activism, altruism, and community-building.

- In effect, by subsidizing the delivery of social services for which the government (and the public) has determined a need, Goodwill's contribute an indirect form of taxation.

Goodwill's activities can better be seen as public good than as unfair competition. Member Goodwills provide services, resources, encouragement, and ideals that increase the public good. This judgment is ratified by institutional evaluators of charities and by the assessment of the American public.

Governments provide for-profit entities with major financial incentives to carry out their work. An examination of recent data concerning for-profits shows that:

- The number of Subchapter S corporations paying no corporate income tax has increased.

- As a result of the financial incentives granted to businesses, as well as to their own decisions regarding expenses, the corporate income taxes paid to the federal government are less than 1 percent of corporate revenues. For-profit social services firms pay an even smaller percentage of their revenues in federal corporate income taxes.

- The SBA serves as a governmental advocate for the interests of small businesses. (Nonprofits have no such counterpart.) The SBA channels financial benefits to small businesses, including $60 billion in federal procurement dollars in Fiscal Year 1992.

- There is some support for the claim that it is for-profits that have been initiating the competition with nonprofits, rather than the opposite.

APPENDIX A

Table 1

1993 Placements by Member Goodwills:
Projections for 179 Member Goodwills[35]

Types of Employment Placements for Goodwill Clients in 1993	Number Placed	Average Wage Per Hour	Average Hours Per Week	Estimated Average Annual Income
Sheltered Employment	2,098	$3.09	29.0	$4,724
Supported Employment	2,422	$4.48	25.0	$5,928
Competitive Employment Within Goodwill	2,602	$4.90	34.7	$8,842
Competitive Employment Outside Goodwill	20,255	$5.36	33.3	$9,281

Note: In 1993 the 179 member Goodwills served a projected 123,176 people in vocational programs. Of these, 22,857, or 18.6 percent, were placed by member Goodwills in competitive employment within or outside Goodwill facilities.

[35]All information for Table 1 comes from Goodwill Industries' *1993 Statistical Report*, pp. 55, 71, 77. In a telephone conversation on 12/28/94 Donald Tolson of Goodwill Industries revised the figure for competitive employment within Goodwill by one person in order to change earlier rounding.

Table 2

Total Annual Earnings, Payroll Taxes and Economic Returns 1993: Projected for 179 Member Goodwills[36]

(1) Total wages earned at Goodwills by clients	$73,277,162
(2) Total wages earned at Goodwills by disabled employees	$95,479,628
(3) Total Goodwill wages for those in line (1) + line (2) above	$168,756,790
(4) Total earnings by those placed in outside competitive positions [20,255 people x $9281 average annual earnings]	$187,986,655
(5) Total purchasing power created [sum of lines (3) and (4) above]	$356,743,445
(6) Estimated total payroll taxes generated [15% of line (5)]	$53,511,517
(7) Investment: Public monetary support for operating expenses	$30,807,778
(8) Economic return: new purchasing power per $1 of public support [line (5) divided by line (7) above]	$11.58
(9) Investment: rehabilitation funding (including governmental grants)	$157,561,227
(10) Economic return: new purchasing power per $1 of rehabilitation funding [line (5) divided by line (9)]	$2.26
(11) Taxes generated per $1 rehabilitation funding [line (6) divided by line (9)]	$.34

[36]Information is from Goodwill Industries' *1993 Statistical Report* and from corrected figures obtained in a telephone conversation with Donald Tolson of Goodwill on 12/7/94.

Table 3

Member Goodwills' Sources of Income and Expenses in 1993 Compared to Average Income and Expenses for the 100 Biggest Charities in 1993[37]

SOURCES OF INCOME:	Goodwill Members (%)	100 Largest Charities %
Public support	10.44	42.83
Government	18.57	22.86
Investment	0.71	5.49
Earned income	69.41	12.82
Program services	0.00	13.34
Other	0.87	4.05
EXPENSES AS % OF INCOME SPENT:	95.15	93.86
Programs—% of total revenue	84.09	81.21
Fundraising—% of total revenue	0.93	4.55
Administration—% of total revenue	10.13	7.68

[37]All information is from John McIlquham, "The Making of the 100," *The NonProfit Times*, November 1994, pp. 23-31.

Table 4

United States Internal Revenue Service Projections for All Corporations in 1991 and 1992[38]

ALL U.S. CORPORATIONS:	1991	1992: (Preliminary)
Total corporate income tax returns	3,802,788	3,868,004
% of total that are S-corporation returns	44.7	46.1
Total receipts	$11.4 trillion	$11.7 trillion
Pretax profits	$344.9 billion	$402.7 billion
Total income tax after credits	$ 92.6 billion	$101.1 billion
Federal tax as % of total receipts	0.8	0.9

[38]Information for Table 4 comes from U.S. Internal Revenue Service, *Statistics of Income Bulletin*, Fall 1994, pp. 180-181.

As of December 1994, the latest information publicly available is for Fiscal Year 1991. Fiscal Year 1992 information is "preliminary" and subject to revision.

Table 5

United States Internal Revenue Service Figures for For-Profits in Minor Industry 8330--Social Services[39]

Social Services For-Profits:	1990	1991
Total No. of returns for active corporations	8,656	12,346
# of returns with net income	3,169	4,584
Total receipts for all returns	$ 3.2 billion	$ 3.6 billion
Receipts for returns with net income	$ 1.6 billion	$ 2.2 billion
Total income tax after credits	$14.9 million (0.5% of total receipts)	$14.0 million (0.4% of total receipts)

Note: Category 8300—Social Services includes individual and family social services, child day care services, residential care, job training and vocational rehabilitation services.

[39]Information for 1990 is from U.S. Internal Revenue Service, *Statistics of Income—1990: Corporation Income Tax Returns* (Washington, D.C.: 1993), pp. 23, 26.

Information for 1991 is from U.S. Internal Revenue Service, *Statistics of Income—1991: Corporation Income Tax Returns* (Washington, D.C.: 1994), p. 23.

Table 6

Financial Information for 501(c)(3) Charitable, Scientific, and Public Safety Nonprofits (Excluding Churches and Church-Related Organizations)[40]

# of 501(c)(3) organizations in 1990	416,209
# of tax returns in 1990*	141,757
Total assets per tax returns 1990	$697.3 billion
Total revenue per returns 1990	$435.6 billion
Total expenses per returns 1990	$409.4 billion

Notes:

501(c)(3) organizations receive the largest proportion of tax-deductible gifts and are themselves tax-exempt. Each 501(c)(3) organization must serve "the public good" in order to qualify for this status. The 501(c)(3) category is broad enough to include nonprofit educational institutions, nonprofit hospitals, public charities, and more.

*Religious organizations and those nonprofits with receipts under $25,000 are excluded from these calculations because they do not have to file Form 990s with the Internal Revenue Service.

[40]Information is from U.S. Internal Revenue Service, "Charities and Other Tax-Exempt Organizations, 1990," *Statistics of Income Bulletin*, Fall 1994, pp. 132-133.

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APPENDIX B

Case Study #1

"John" graduated from high school at 18 year of age, and that same summer entered the military where he learned a trade as a machinist and gained valuable experiences living on his own.

After four years in service, John was discharged and returned home with great expectations of finding a job and beginning a new life. Soon afterwards, he met Pamela, who moved into his small apartment just outside the city. In three short years they had two children. John had difficulty adjusting to the stress of a new, young family. Making the transition from the military to civilian life was also more difficult than he expected, and his inability to find suitable employment added to the pressure. He took odd jobs to help make ends meet, but at $6.50 an hour he was unable to support a family of four. Pamela began to work and was the sole provider for the family during his period of unemployment.

John often thought of returning to the military to start over again. He began to drink and take drugs to escape his daily responsibilities. When he was fired from his second job in four months, Pamela took the children and moved away to avoid his abusive behavior. He became depressed and withdrawn. Looking back, he realizes he was not ready for the many changes that occurred over such a brief period of time. His dependency on drugs and alcohol contributed to his inability to maintain employment and a stable home environment for his family. With the help of a friend, he was admitted to the VA rehabilitation hospital, where he received inpatient treatment for alcohol and drug abuse for a period of six months.

A counselor at the VA hospital referred John to Goodwill Industries for job-training. Following a short assessment at Goodwill, John entered a six-month Occupational Skills Training Program for Dental Assistants. He gained support from his peers and developed goals and a new direction for his life. With the aid of Goodwill's Business Advisory Council, he was assigned a mentor and granted an internship at Marquette University. His performance appraisals indicated that he was an exemplary employee, with the discipline necessary to do a good job. At Goodwill, he acquired job-search skills training and a renewed sense of self-worth. He is currently employed as a Dental Assistant, earning $8.67 per hour.

John has overcome significant barriers in his personal life and looks forward to bringing his family back together. In many ways has been able to start all over again. As a Dental Assistant, John interviews patients, measures vital signs and offers chairside assistance. He belongs to several professional associations and takes much pride in his work.

John is self-sufficient with a new job and a bright future. By developing new skills, receiving job-placement assistance and ultimately being placed in a position with high earnings and better job retention, his chances of long-term economic security are increased. He attributes his success to Goodwill for his ability to find and maintain employment, preventing him from becoming dependent on the welfare system. With Goodwill's help and the assistance of an ongoing support group, he has made a complete turnaround.

Case Study #2

"Alex" is a self-made man with more than 25 years of stable work history. His position evolved into vice president of operations in a local manufacturing business, where he originally began his employment in the production area. He didn't need a college degree to do the entry-level work and found that determination, imagination and dedication propelled him through the ranks. He liked his work at the company and was proud of his accomplishments. He provided a good living to support a growing family. Alex was happy with his middle class life-style and had no reason to suspect that his future was not secure.

Alex's medical problems started with what seemed like a simple diagnosis of recurring foot infections. Before he was forced to resign his position a year later, he had been hospitalized for dehydration. Alex learned he was in the end stages of renal disease. He was soon plagued with fluid overload which resulted in recurring, exhausting dialysis treatments. He was physically and emotionally battered as he waited for a donor kidney that would be a compatible match. The first transplant was rejected and Alex was forced to return to cycles of dialysis treatments and waiting for another available kidney. It wasn't until the third transplant that his body accepted the new organ and he began the road to recovery.

Alex wasn't prepared for the permanent adjustments to his life. His recovery had to be psychological as well as physical, and he wasn't going to be able to do it alone. When he felt physically able to return to work he faced several barriers. He was an older man with limited skills reentering the workforce; he was medically unstable, needing semi-weekly medical treatments; he was a high-cost insurance risk to potential employers; he had a limited education and he refused to consider anything less than a management position. His situation required financial assistance for medical and daily living needs -- he was receiving approximately $800.00 per month from Social Security Disaility Insurance (SSDI) along with Medicare benefits.

Alex determined that he needed college in order to compete in the workforce again. The state helped him pay for college and then paid for additional services at Goodwill Industries. At Goodwill, he participated in an intense series of placement-related activities that included assessment, job-seeking skills, resume writing, job development, interviewing techniques, etc.

Three years after he lost his job, and one year into the program, he independently negotiated wages and benefits for a position as a purchasing supervisor. He is currently

earning $2,000.00 per month more than the benefits he was receiving from SSDI and Medicare. Goodwill staff provides follow-up and support for Alex and his employer.

Alex is employed in a position which has allowed him to recoup many elements of his former existence. He no longer requires state and federal assistance to meet daily expenses. Although he still has medical needs, he has returned to a familiar lifestyle; he has a sense of purpose and he has accomplished personal goals. He now has a stable source of income that provides for a decent standard of living and job-related benefits to cover medical expenses. He is no longer in need of financial assistance from state or federal sources.

Case Study #3

"Mary" is a 46-year old single woman with a Masters Degree in Education. She taught visually impaired children in Boston before developing a Partial Complex Seizures syndrome. Independent functioning ceased because of the residual effects of the seizures, which include memory and information sequencing difficulties (the inability to concentrate for even short periods of time) and incontinence. She could not complete simple memory tasks, use the public transportation system or recite her address consistently without notes. Mary immediately became a candidate for services she should have been able to receive from "the system," but could not access.

Mary was unable to live alone and moved in with her widowed mother, who currently pays for a dental plan, food and much of the medication Mary requires while they explore available options. She initiated a self-referral to the state vocational rehabilitation office and waited nearly a year before starting with Goodwill. Although she was accepted into the program, she physically could not get there. She was not capable of using public transportation and could not afford to use the subsidized county system that had been established for individuals with disabilities. There weren't any other viable options for services in the area where she lives. She sat at home. Mary was unproductive, depressed, and her condition was deteriorating.

Mary will not regain the capacity to perform as she did prior to the onset of the seizures, but has mastered elementary use of the bus system with the assistance of maps and written directions/instructions, and has enrolled in Goodwill. She is unlikely to reenter the competitive employment market, so Goodwill will continue to provide ancillary services to improve her quality of life in areas other than those related to employment. Mary loves her work at Goodwill. She performs simple, repetitive tasks at 43% of the standard. She looks forward to going to a place where she's comfortable, and is not humiliated by seizure activity and the ensuing incontinence. She has developed a circle of friends and support network. She is productive and satisfied. Income earned in subsidized employment has resulted in benefits to the quality of life of an individual, which cannot be measured in dollars.

Mary's Individual Written Program Plan (IWPP) was developed with the Department of Rehabilitative Services. It calls for extended (sheltered) employment, although supported employment has not been ruled out as an option for the future. Goodwill is available to assist Mary in accessing a variety of services that are expected to enhance her quality of life and give her a secure future. In the meantime, Mary has a purpose in life -- she has a job which provides intrinsic rewards, friends, and the promise she will always be a valuable member of the Goodwill Industries workforce.

Goodwill Industries International, Inc.
9200 Wisconsin Avenue, Bethesda, Maryland 20814
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July 18, 1996

Dennis Pastrana
President

The Honorable Jan Meyers
Chair
Committee on Small Business
U.S. House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515-6315

Dear Representative Meyers:

Goodwill Industries of South Florida, Inc. has a vital interest in your Committee hearings regarding Unfair Government Support of Competition. We would like to offer these thoughts for the Committee's consideration regarding Public Law 92-28, the Javits-Wagner-O'Day Act (JWOD) and people with disabilities.

Goodwill Industries' mission is to help people with disabilities receive rehabilitation, training and employment services to help them make the transition from dependence to competitive employment and self-sufficiency. In 1995, we served 1,586 people with physical, mental and emotional problems. Over 95% lived below federal poverty guidelines and had a history of homelessness, abuse, neglect, and many other problems.

Last year Goodwill successfully rehabilitated 1,122 individuals. 512 of them went on to pursue opportunities through vocational schools, colleges and other personal goals previously impossible. 610 became competitively employed in the local labor market, where they will earn $5.6 million during the first year of full employment. Goodwill operates many entrepreneurial activities, mostly under the JWOD Program, which serve as a tool for providing training and employment to the disabled while they receive the rehabilitative services that will help them become employable. Last year we paid $2.7 million in wages to people in this group. In a single year, Goodwill programs created $8.3 million in new earning capacity for people with disabilities previously unemployed and unemployable.

Our revenues derive 85% from Goodwill's entrepreneurial, industrial and commercial activities, 11% from government fees and grants, and 4% from United Way. The earning capacity of the $8.3 million created in 1995 is 415%—a sum greater than all of the funding Goodwill received from the government and United Way. Goodwill Industries created a $4.15 return for every dollar received from United Way and governmental sources combined!

The Honorable Jan Meyers
Page Two
July 18, 1996

Despite our demonstrated effectiveness, government funding has declined over the last five years and is anticipated to be substantially reduced as a result of Congressional efforts to eliminate and/or consolidate many training programs. United Way funding will also continue to be reduced as a result of more local competition to meet reduced funding of other local community needs. The only avenue left to us as a means of providing opportunities for people with disabilities is the JWOD Program. It is designed for individuals with physical, mental and emotional problems, who through no fault of their own, cannot make the transition to independence without help.

According to the President's Committee on Employment of People with Disabilities publication of October, 1995, "Each year, the federal government spends 40 times more money to support people with disabilities NOT working than it spends to assist them to prepare for or find employment. The lack of labor force participation of people with disabilities costs our nation's economy over $200 billion annually." According to a January 1994 Harris Poll Survey of the 49 million Americans with disabilities, "over 60% of all working age Americans with disabilities are NOT participating in the work force either full or part-time. Further, 76% of all Americans with severe disabilities do NOT work either full or part-time."

Given the need to cut the federal deficit and the on-going efforts on the part of the U.S. Congress to reduce welfare and consolidate and eliminate training programs, it is imperative to provide avenues that will provide opportunities for people with disabilities to become productive. America cannot afford the tremendous loss of human and economic potential of people with disabilities.

Instead of more welfare, more funding for training and rehabilitation programs, government support of the JWOD Program has proved itself to be a more effective means of providing people with disabilities the opportunity to become productive, tax paying citizens. It is the most effective way to help people become tax payers instead of tax users.

Sincerely,

Robert Bromberg

Robert Bromberg
Vice Chair, Goodwill Board of Directors

FAIRFAX
OPPORTUNITIES
UNLIMITED

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July 30, 1996

Janet E. Samuelson
President & Chief Executive Officer

The Honorable Jan Meyers
United States House of Representatives
Washington, D.C. 20515

Dear Madam Chairwoman:

I would like to correct some of the testimony that was provided at the "Unfair Competition" hearings of the Small Business Committee. During the hearing, there was testimony which implied that Javits-Wagner-O'Day (JWOD) programs are somehow consistent with poor quality jobs or a medical model of services. My experience is exactly the opposite. The JWOD program provides one of the best opportunities today for individuals with disabilities to become self-sufficient, contributing workers.

Our organization makes substantial use of the JWOD program to create work options for people with disabilities. We employ over 200 individuals in JWOD contracts who earn an average wage of $8.70 per hour. We provide health and retirement benefits to enable people to leave public subsidies. The contracts are performed in Federal buildings and provide an integrated, productive work environment. The quality of jobs is such that we have an on-going waiting list of over 100 people desiring employment in JWOD programs specifically. There are certainly many programs in the disability arena which foster an outmoded medical model of services and encourage dependency, but JWOD is not among them.

It may be true that a minority of people "graduate" from the JWOD program to competitive employment. However, that is far more an indication of the still very real lack of opportunities for people with disabilities in the private sector of full-time jobs which provide the level of wages and benefits to allow self-sufficiency. Despite passage of the Americans With Disabilities Act, there are still significant barriers for people with disabilities in employment.

We actively partner with accommodating private businesses whenever possible and operate several model programs. We value those partnerships, but also find that there are not nearly enough opportunities for people with disabilities for people who would work. The JWOD program promotes work and self-sufficiency as the ultimate empowerment tool, consistent with the values that most of us hold.

Accredited by CARF
6295 Edsall Road, Suite 175, Alexandria, Virginia 22312, Phone (703) 461-6000, Fax (703) 461-3906, TDD (703) 461-7905

The Honorable Jan Meyers
July 30, 1996 - Page 2

I would welcome you, or any or the other Committee members who are interested in accurate information on this program, to contact me for a visit to our JWOD sites in the Washington, D.C. area. The program is critical to meaningful work opportunities for people with disabilities and I appreciate the opportunity to share its value.

Sincerely,

Janet Samuelson
President

American
Rehabilitation
Association (formerly NARF)

August 8, 1996

Representative Jan Meyers, Chair
House Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515

Dear Madam Chair:

The American Rehabilitation Association represents private nonprofit vocational rehabilitation service providers. Our members serve people with disabilities through job training and placement and other support services. A popular means of employing people with disabilities in meaningful work is through contracts awarded via the Javits-Wagner-O'Day (JWOD) program (41USC46-48).

As you know, the Small Business Committee held a hearing on July 18, 1996 exploring the accusation made by some small business owners that JWOD contracts provide rehabilitation agencies with an unfair advantage over for-profit small business. The American Rehabilitation Association disagrees that JWOD contractors compete unfairly. We ask the Committee to consider the overall economic and social benefit that is derived from the employment of people with disabilities through JWOD contracts.

- As of 1994, JWOD participants earned between $95.4 and $102.7 million more than they would have earned in the absence of the program.
- As of 1994, JWOD participants contributed a total net increase in taxes paid (income, Medicare, and Social Security) of between $17.6 and $18.9 million.
- JWOD participants receive qualitaive benefit such as greater self esteem, increased disposable income, vocational skills which may be transferable into the competitive work market, and enhanced personal and economic independence.
- Rehabilitation agencies possessing JWOD contracts pay payroll taxes and other fees to both federal and state/local governments. In addition, the charitable mission of vocational rehabilitation programs represents a clear benefit to our society as a whole.

The JWOD program offers greater opportunity to a segment of our society currently experiencing a 69 percent rate of unemployment. Without JWOD as a placement tool, many vocational rehabilitation providers will not be able to sustain their current level of services to people with disabilities.

Sincerely,

Jenn Rigger
Director, Vocational and Developmental Services

1910 Association Drive • Reston, Virginia 20191 • 800/368-3513 • 703/648-9300 • Fax 703/648-0346

THE SECRETARY OF VETERANS AFFAIRS
WASHINGTON

AUG 14 1996

The Honorable Jan Meyers
Chairperson
House Committee on Small Business
House of Representatives
Washington, D.C. 20515

Dear Madam Chair:

The purpose of this letter is to offer comments for the Committee Hearing Record (enclosed) concerning testimony provided to your committee by Mr. Lou O'Brien, representing Textile Rental Services of America, during hearings held on July 18, 1996.

Thank you for the opportunity to submit comments for the record. Should your committee have any questions regarding these comments for the record, please contact Mr. Ken Tyler, Environmental Management Service, Veterans Health Administration at (202) 273-8397.

Sincerely yours,

Jesse Brown

Jesse Brown

Enclosure

JB/kt

Putting Veterans First

Department of Veterans Affairs
Veterans Health Administration
Comments for the Committee Hearing Record

The purpose of this paper is to address reported written and oral testimony presented to the House Committee on Small Business, July 18, 1996, regarding "Unfair Government-Supported Competition with Small Business". The reported remarks made by Mr. Lou O'Brien representing Textile Rental Services of America, concerned the Department of Veterans Affairs Laundry Program providing poor quality service at unreasonable prices and, that as a result, Congress needed to take action.

"Comments for the Committee Hearing Record"

The Department of Veterans Affairs (VA) operates one of the world's largest laundry systems, with 88 laundry facilities providing services to VA Medical Centers, and in support of numerous Department of Defense requirements, accomplished through legislated sharing programs. VA laundry systems provide quality services which are monitored through an independent national quality assurance program, managed by the University of Kentucky. VA laundry processing quality is rated by this program as "exceptional" in a majority of instances.

VA laundries are routinely reviewed for cost effectiveness through the Office of Management and Budget A-76 programs, where VA costs are compared to private sector costs. Since 1975, VA has conducted over 70 cost comparison reviews. The results of these reviews indicated that VA laundry processing costs were 20-30% lower than private sector costs. On three (3) occasions, based on cost reviews, VA did contract out to the private sector.

VA's laundry modernization program, through efforts in automation, integration, and energy management has generated operational savings of over $150 million, and cost avoidances of over $100 million since establishment of that program in 1981.

Contracting with mandatory procurement sources such as the National Industry for the Severely Handicapped (NISH) is also reviewed based on cost reasonableness. VA Medical Center, Danville, IL, did contract out with NISH for laundry services as this was determined to be mandated preferential procurement action.

VA policy requires contractors to meet all Joint Commission on Accreditation of Healthcare Organizations, Occupational Safety and Health Administration and VA standards for processing laundry.

July 10, 1996

House Small Business Committee
2361 Rayburn House Office Building
Washington DC 20515-6315

My company is involved in an injuction against a state owned hospital in Alabama. The hospital has created a home medical equipment business to control all home patient referrals that were previously handled by the private sector.

The for profit business established by the state owned hospital is controlling all patient referrals that are private and medicare funded. By monopolizing all home patient referrals they are not only violating the patient freedom of choice but the past checks and balances in the system were eliminated.

As a tax payor, I find it unconscionable that my tax dollars are being used to put me out of business. The state funded hospital uses state tags on their delivery vehicles, don't pay liability insurance or workers compensation and they control all patient referrals.

Does this country stand for fair and free competition or will we continue on the path to socialism? I urge you to adopt the recommendations of the business coalition for fair competition.

Please let this letter be included as a part of the hearing record for the July 16 and July 18 hearings on competition.

Sincerely,

Wm. Craig Browne, Jr.
Vice President

LIBERTY MANAGEMENT CONSULTANTS
P.O. Box 3303, Johnstown, PA 15904-0303 (814) 266-7990
CONFIDENTIAL

July 12, 1996

House Small Business Committee
2361 Rayburn House Office Building
Washington, DC 20515-6315

I am requesting that this letter be included as part of the hearing record for the July 16 and 18 hearings on competition. I have included examples to illustrate my views on "unfair competition" by the M.S. Commerce Department's NIST-MEP Program. I urge you to adopt the recommendations of the Business Coalition for Fair Competition.

This letter deals with **"Corporate Welfare"** to the extent that the U.S. Commerce Department NIST Manufacturing Extension Partnership (MEP) funds private non-profit companies that provide management consulting services to manufacturers in competition with private consultants. It grieves me to pay federal and state taxes and my electric utility bill and have these sources, in turn, fund private non profit corporations to compete against me.

STATE

I am the owner and sole employee of a small consulting firm that primarily serves the manufacturing sector. In Pennsylvania, the Commerce Department funds eight (8) regional Industrial Resource Centers (IRC's) that also serve the manufacturing sector with comparable management consulting services. As I understand, originally the IRC's matched-up manufacturing firms with management consultants and funded a portion of each consulting engagement fee. Most IRC's now have their own full-time consultants that provide management consulting services in competition with private consultants. All IRC's also still fund third party consultants, which creates an obvious conflict.

FEDERAL

Under the US Commerce Department's National Institute of Standards and Technologies (NIST) Manufacturing Extension Partnership (MEP) Program, some Pennsylvania IRC's have qualified as Manufacturing Extension Centers (MEC's) and receive substantial federal funding. Other Pennsylvania IRC's receive NIST MEP funding through the established MEC's. In this letter IRC's will be referred to as MEC's because they receive NIST MEP funding either directly or indirectly. There are presently sixty (60) established MEC's throughout the country and the NIST MEP annual budget is $80 million. The Cato Institute identified 125 programs that directly assist business at a cost of $75 billion a year to the federal government. NIST MEP is one of these programs.

NIST MEP told me that my firm did not qualify to become a MEC, but that I could receive project engagements and/or engagement funding from MEC's in my area. I said that I never received anything from any of the four (4) MEC/IRC's with which I am registered. In fact, MEC's are my biggest competitors and have caused me to lose clients by not funding my projects and/or performing the projects with their own full time consultants. NIST MEP told me that MEC's are not supposed to compete against private consultant's and are to operate in their own regions. I told NIST MEP that both of their rules are being violated in Pennsylvania, yet they have not corrected this problem. In fact, the grant agreement between the state and the MEC's (IRC's) list the counties within their respective regions. Electric utilities also have agreements with MEC's to provide consulting services for manufacturing clients in the utility's service territory which are located in and out of the MEC's designated region.

NIST suggested that I respond to the attached RFP in the Commerce Business Daily and submit a proposal for federal funding to prepare a training program to train MEC personnel in consulting tools (skills). The MEC's will

then use these tools to compete against me. I don't agree with this philosophy. If the MEC personnel were qualified consultants, they should not need this training. Nevertheless, I submitted three (3) proposals and all three (3) were rejected.

U.S. Senator Arlan Spector wrote to the NIST MEP director and received a response that did not address the issues. U.S. Senator Rick Santorum's office called NIST MEP and was told that they were too busy to respond, and to date have not responded. My U.S. Congressman has not taken any action to help me. He was instrumental in establishing a large federally funded local company that also competes against me. The actions taken by the two (2) U.S. Senators and me may have influenced the rejection of my NIST MEP training proposals.

ELECTRIC UTILITIES

In Pennsylvania, the utility commission encourages competitive bidding for goods and services that are purchased by public utilities. However, electric utilities sign sole source contracts with MEC's to provide consulting services to the utility's manufacturing customers, in light of the fact that the MEC's are funded by the state and federal governments and directly compete with the private sector. The utilities, in fact, assist MEC's by marketing and subsidizing MEC consulting projects, establishing pools of funding from which MEC's can draw to fund consulting projects, and establishing loan pools from which manufacturing firms can draw to finance capital projects.

The electric companies typically market assessment studies for the MEC's and share in the payment of the MEC consulting fee with the manufacturing client. Also, in order to receive electric company funding for a private consultant project, the manufacturing client must write to the MEC to receive approval. It's like living in Russia and having to secure project funding through the KGB.

ASSESSMENT STUDIES

A typical one-week assessment study by MEC consultants is normally shared equally between the electric utility and the manufacturing client. This is income for the MEC. It is more profitable for an MEC to perform this type of study rather than fund third party consultant projects. By using their own consultants to perform assessment studies instead of funding a private consultant project, the MEC receives income and avoids funding a portion of the consultants engagement, which is a conflict. It should be noted that MEC's are private non profit companies that are exempt from federal and state income taxes.

I submitted proposals to electric companies and MEC's to perform one-week assessment studies for one half the MEC cost. My proposals were rejected by the electric companies and the MEC's.

CONCLUSION

It is very discomforting for me to see large amounts of federal and state funding going to MEC's to perform my work. This is another case of big government and big business running our lives. I hold a B.S. degree in Industrial Engineering with thirty (30) years of related experience and I can't find a consulting engagement, or I find one and a MEC ends-up with the project. This is not reflective of the American free enterprise system. This is reflective of socialism.

In trying to get my consulting business going over the past four (4) years, I have made over four hundred (400) contacts and only performed two (2) consulting engagements, yielding an annual savings to fee payback ratio of 6 to 1. Like most Americans, I have the responsibility to support my family in educating my children and caring for my sick wife. However, unlike most Americans, I do not have the freedom to fully compete under prevailing circumstances. They playing field is not level.

If you have any questions or comments or feel that you can assist me, I can be reached at (814) 266-7990. Thank you.

Sincerely yours,

H. Robert Parsons

LIBERTY MANAGEMENT CONSULTANTS
P.O. Box 3303, Johnstown, PA 15904-0303 (814) 266-7990

HOTLINE
US Commerce Department
P.O. Box 612
Ben Franklin Station
Washington, DC 20044

Dear Sir or Madam:

As requested, I am submitting information about Southwestern Pennsylvania Industrial Resource Center (SPIRC), which is funded by the US and State Commerce Departments. SPIRC is in their second year of a $3.25 million two (2) year NIST MEP grant. I understand that NIST MEP has an annual budget of $80 million and is one of 125 programs that provide "corporate welfare," which costs the US Government $75 billion annually. NIST MEP personnel told me that SPIRC violated the following:

- MEC's are not supposed to compete with private consultants.
  - SPIRC has competed against me and other consultants and has undercut me causing me to lose clients.
- MEC's are not to operate outside of their designated region.
  - SPIRC consultants regularly perform client engagements outside of their 13 county region. They took two clients from me outside of their region. They operate in other IRC regions without notifying them. The Pennsylvania Electric Company markets and subsidizes SPIRC's consulting projects inside and outside of SPIRC's region.
- MEC's are not to fund third party consultants with NIST MEP funds.
  - SPIRC uses MEC funds for consultants inside and outside of their region.

In light of the above violations, to the best of my knowledge, NIST MEP has not taken any corrective action with SPIRC.

All of the above areas are covered in the attached correspondence. When I complained to NIST MEP, they said that the MEC's are supposed to assist consultants in obtaining manufacturing client engagements. SPIRC has never called me on an engagement. When I find a client, SPIRC normally ends up with the client. Instead of marketing my services, I am in fact, marketing SPIRC's services. Rather than funding me $5,000 for a client project, SPIRC takes the client and charges a $5,000 fee for a one-week assessment study, which is normally shared between the client and an electric utility, which has sole-source contracts with SPIRC consultant. In effect SPIRC's unethical actions nets them $10,000 ($5,000 + $5,000) which is also a conflict. SPIRC is a nonprofit corporation that receives $4 million in funding and charges fees for their consulting service.

It should also be noted that US Senator Arlen Spector wrote to NIST MEP about SPIRC and received a reply letter (attached) from the NIST MEP director which did not address the issues. US Senator Rick Santorum's office called NIST MEP and their response was that NIST MEP was too busy to respond due to the federal government shutdown. My US Congressman John Murtha did nothing on my behalf, probably because he was instrumented in establishing the Concurrent Technology Corporation in my home town, which is fully funded by the federal government and competes against me with consulting services. The correspondence to and from the two (2) US Senators and Congressman are attached.

NIST MEP also suggested that I participate in competition by submitting an RFP for NIST MEP funding to prepare tools training programs. If awarded, I would have received a MEP grant to prepare a training program to be used to train MEC personnel the consulting tools (skills) they can use to in turn compete against me and other qualified consultants. I submitted three (3) tools training proposals and all three were rejected.

I feel that the rejections may have resulted from the complaints made by the two (2) senators and me. I would like this checked into because I may have been discriminated against because of the actions taken against NIST MEP regarding the SPIRC issue.

Following my rejection, I was briefed by three (3) NIST MEP personnel. It appeared to me that the three (3) individuals may not have been qualified to evaluate my three (3) proposals because they had no questions or comments about the technical content. They were concerned about the submittal procedures. As an example, they asked why I used my client companies as participating organizations in the training proposal. They said that I should have used an MEC, such as the one in Pittsburgh (SPIRC). I covered the following with them:

1) An "organization" was not defined in the application project.
2) When I called NIST MEP earlier to determine what an "organization" was, no one was available to answer my question(s), because they were on furlough due to the government shutdown.
3) I couldn't work with SPIRC as a participating organization because they are the "enemy."

SPIRC is not the only Pennsylvania IRC that competes against me. MANTEC, York, Pa., and the IMC, Mountoursville, Pa., receive funds through the Delaware Valley IRC (MEC) in Philadelphia to provide assessment studies like SPIRC. I submitted proposals to perform one-week assessments studies, but was rejected. I also submitted the same proposals to the electric utilities in SPIRC's region and I was also rejected even though my one week assessment are half the cost of SPIRC's ($2,500 vs. $5,000). Also, if I needed electric company money, to fund one of my proposals, my client is required to write to SPIRC to request funding from the electric company. This is like living in Russia, with SPIRC serving as the watchdog for federal, state, and electric company funding. It's like having to go to the KGB.

I do not stand alone on this issue. Mr. Andy Imhat (412-238-4279), a local consultant called NIST MEP about the Bedford Reinforce Plastics engagement (covered in the attachments) in which SPIRC consultants have been active outside of their region. Mr. Imhat became upset

when he got the "run around" from a NIST MEP employed who could not provide him with answers.

Earlier this year I attended a meeting of the Pittsburgh Chapter of the Institutes of Management Consultants and I was the only consultant there who served the manufacturing sector. As U.S. Senator Rick Santorum's legislative aid said, "manufacturing consultants are becoming as extinct as dinosaurs." I understand that SPIRC has about thirty (30) employees. What will happen if the NIST MEC and the Pennsylvania IRC money "dries-up"? Will there be sufficient private consultants available?

I have been a consultant for four (4) years and have made over 400 contacts, but have only had two (2) consulting engagements. I have children to educate and a sick wife to care for. I hold a BS in Industrial Engineer with over thirty (30) years related experience and I can't make a living. I regularly draw from my savings to support my family. I need help.

I would like to see the following occur:

- Stop SPIRC consultants from competing with the private consultants. In fact, SPIRC consultants should be eliminated. This holds true for the other IRC's (MEC's) as well.
- Keep SPIRC in their region.
- Break the ties between SPIRC and the electric utility, i.e. no marketing and no subsidation.
- NIST MEP should pay me for the projects that SPIRC took from me.
- I should be awarded one or more of the three tools training projects that NIST MEP rejected.

I am fed-up with this "unfair competition." I am tired of big government funds being used to compete against me. Perhaps we should try the free enterprise system and see if it still works.

If you have any questions or comments or need additional information, I can be reached at (814) 266-7990 or faxed at (814) 266-8230. Thank you.

Sincerely yours,

H. Robert Parsons
President

LIBERTY MANAGEMENT CONSULTANTS
P.O. Box 3303, Johnstown, PA 15904-0303 (814) 266-7990

CONFIDENTIAL

May 29, 1996

Ms. Marie Stopher
Director, Med Atlantic
Manufacturing Extension Partnership
Building 301, Room C121
National Institute of Standards & Technology
Gaithersburg, MD 20899-0001

Dear Ms. Stopher:

On May 9, 1996 my consulting firm had a vendor exhibit at the Pennsylvania Electrical Association (PEA) meeting in order to interface with electric utility marketing personnel and familiarize them with my firm's management consulting services. SPIRC had a vendor exhibit their, as well. In talking with the SPIRC representative, he reviewed my enclosed Total Cost Management brochure and, in particular, the backside entitled "Other Management Consulting Services offered by Liberty." He said that since SPIRC consultants offered all of these services except Maintenance Management and Budgeting, that they would not issue grants to clients to cover fees for third party consultants to perform engagements in these areas. He indicated that SPIRC offers client grants for private consulting engagements in specialized areas such as environmental and ISO 9000. He encouraged me to get into ISO 9000. He also said that SPIRC ran out of consultant funding and that new funding would not be available until July 1, 1996. Last year SPIRC's president told me that new funding would not have been made available until September 1, 1995, while the other IRC's were getting their new state funding on July 1, 1995. Also, he noted that IRC and MEP funding went into the same "pot" for SPIRC operating expenses.

I also talked with Penelec's Marketing Manager that covers Bedford and Blair counties where I am marketing my consulting services. Although these two (2) counties are in IMC's designated IRC region, he said that he will not deal with the IMC. Penelec has a contract with and deals only with SPIRC regarding the funding of consulting projects for Penelec's industrial customers. He told me that if one of my client companies wanted IRC and/or Penelec funding to cover a private consultant project that the client would have to write SPIRC and request SPIRC and Penelec funding. If SPIRC approved the request, they would forward it to Penelec for review and approval.

My interpretation of this is:

- SPIRC will not approve private consultant grants for clients requesting my firm's consulting services, where, for the most part, SPIRC consultants perform these services.
  - Request for funding to cover my firm's consulting services could result in SPIRC taking my client as they did with Royal Monarch, particularly since they are now out of funding for third party consultants.
- If IRC funding for third party consultants would have been made available last year on July 1 instead of September 1, as SPIRC indicated, I would not have lost my two (2) clients - Royal Monarch and Rockwood Manufacturing. SPIRC may have still taken my clients because they don't fund private consultant projects that SPIRC consultants perform. It appears that I am, in fact, marketing projects for SPIRC's consultants.
- It also appears that my clients would not get Penelec funding as well, because the release of Penelec and Duquesne Light funds is contingent upon SPIRC's approval of my project. Again, SPIRC would not approve funding for private consultant's if SPIRC consultants perform these same services.

In effect, this means that my clients, for the most part, would not obtain SPIRC, Penelec or Duquesne Light funding for my firm's consulting projects to be performed in and outside of SPIRC's region. IMC is probably not happy with this arrangement, as well. The Pennsylvania and US Commerce Department's are funding this unfair competition. I just started a client engagement. This is my first project since last summer. I satisfactorily completed one client engagement in 1995 and one in 1994, none of which were referred by an IRC and none of which received IRC funding. It is very discouraging to be the only manufacturing sector of management consultant in the area and have to compete with a large state and federally funded IRC that is tax exempt and subsidized by large electric utilities.

Please respond. Thank you.

Sincerely,

H. Robert Parsons
President

LIBERTY MANAGEMENT CONSULTANTS
P.O. Box 3303, Johnstown, PA 15904-0303 (814) 266-7990

CONFIDENTIAL

April 11, 1996

Ms. Marie Stopher
Director, Med Atlantic
Manufacturing Extension Partnership
Building 301, Room C121
National Institute of Standards & Technology
Gaithersburg, MD 20899-0001

Dear Ms Stopher:

As covered in the attached letter, I lost another client to SPIRC. I previously wrote you about losing Bedford Reinforced Plastics and, now Breezewood, Inc. which are both outside of SPIRC's region. These are not two (2) isolated incidents. SPIRC's practice of operating outside of their region is widespread

Penelec markets and funds SPIRC's consulting services in their service territory. Altoona Enterprises, an economic development group located in Altoona, Pa, also assists SPIRC in obtaining manufacturing clients in Blair County; however, they were not aware that a manufacturing management consultant, such as I, was located in the area. I am registered with SPIRC and they are aware of the consulting service that my firm offers, yet they have not called me for any projects. My availability is such that I can travel to most all manufacturing firms, located in Blair and Bedford Counties within one hour from Johnstown

I can provide the names of other companies that employed SPIRC consultants outside of SPIRC's region; however, a more complete listing can be provided by:

Frank DeNapoli, NWIRC (814) 371-7379
John Maylie, IMC (814) 237-5539
Barry Surma, Altoona Enterprises (814) 944-6113

It should be noted that the state grant agreement with SPIRC lists the twelve (12) counties that represents their region. I assume that this is also the same region covered by the NIST MEP. Penelec also has a contract with SPIRC that states that they can use SPIRC consultants in their electric utility service territory, which covers 40% of the land mass of Pennsylvania. There are only three counties that are within Penelec service territory and SPIRC's region. Penelec actively markets and funds SPIRC consultants to their manufacturing customers.

I have lost four (4) clients to SPIRC consultant's in the past eleven (11) months, which is twice as many clients that have engaged my services in the past four (4) years. Since this January I have made over one hundred (100) contacts in Blair County and I was not successful in engaging one (1) client. Many SPIRC clients in Blair County had previously engaged their consultants for one (1) week operations reviews and were not interested in engaging my consulting services.

When I marketed my services in Blair County one (1) year ago the New Pig Corporation engaged my services although they had previously engaged SPIRC consultants for a one-week study. I studied one half of New Pig's operating facility and generated $200,000 annual recurring savings for a $25,000 fee and improved productivity by 50% I reported the New Pig project to SPIRC in order to update my consultant data base experience, yet they continue to ignore me, although I am the only manufacturing consultant in the Blair County area

It appears that SPIRC's second project at Breezewood, Inc. is beyond the assessment-type study. They are now cutting deeper into specialized consultant projects which is more blatant competition exerted by a large government funded, non-profit consulting firm. SPIRC's actions are unethical, according to the attached Code of Ethics of the Institute of Management Consultants. If you have no ethics code covering SPIRC, this code should prevail. At this point, I don't know if SPIRC actions are illegal, buy they are personally abusive to me.

I have suffered considerable anxiety which has detrimentally affected my health and the well-being of my family. I personally do not understand why the Commerce Department has not taken action to correct this condition. Other consultants and MEC's/IRC's in Pennsylvania and neighboring states are appalled at SPIRC's actions and how they are affecting me. I am requesting that you put a stop to SPIRC's actions immediately and recompense me for the losses that I have suffered. I would hope to receive a written response regarding this matter.

If you have any questions or comments, please call me at (814) 266-7990. Thank you.

Sincerely,

Bob Parsons

H. Robert Parsons
President

cc: Mr. Kevin Carr, Director

Code of Ethics

Clients

1. We will serve our clients with integrity, competence, and objectivity.

2. We will keep client information and records of client engagements confidential and will use proprietary client information only with the client's permission.

3. We will not take advantage of confidential client information for ourselves or our firms.

4. We will not allow conflicts of interest which provide a competitive advantage to one client through our use of confidential information from another client who is a direct competitor without that competitor's permission.

Engagements

5. We will accept only engagements for which we are qualified by our experience and competence.

6. We will assign staff to client engagements in accord with their experience, knowledge, and expertise.

7. We will immediately acknowledge any influences on our objectivity to our clients and will offer to withdraw from a consulting engagement when our objectivity or integrity may be impaired.

Fees

8. We will agree independently and in advance on the basis for our fees and expenses and will charge fees and expenses that are reasonable, legitimate, and commensurate with the services we deliver and the responsibility we accept.

9. We will disclose to our clients in advance any fees or commissions that we will receive for equipment, supplies or services we recommend to our clients.

Profession

10. We will respect the intellectual property rights of our clients, other consulting firms, and sole practitioners and will not use proprietary information or methodologies without permission.

11. We will not advertise our services in a deceptive manner and will not misrepresent the consulting profession, consulting firms, or sole practitioners.

12. We will report violations of this Code of Ethics.

Approved on January 8, 1991.

Standards of Independence

- The purpose of my business is the provision of advise or assistance about a process of management to clients with management responsibilities.

- I am either a solo practitioner of management consulting or a member of a firm, group or division specifically charged with providing management consulting services.

- It is not an objective of my position to promote, provide technical support for, or sell the non-management consulting interests of my employer, parent company or affiliated entity.

- Both I and my consulting practice are free to select or reject consulting assignments based on professional grounds or to resign from an assignment for ethical or other professional reasons.

- My clients are free to select the consultants they will engage for an assignment, to reject a proposal by me or my consulting practice and to terminate an engagement on performance grounds.

- Before beginning a consulting assignment, I reach a mutual understanding as to the terms of the engagement with my clients.

- During the course of conducting a consulting assignment, I am free to exercise professional judgement without influence or interference from the non-consulting interests of my employer, parent company or affiliated entities.

over

Membership

The Institute of Management Consultants represents a broad and growing segment of consulting professionals. Consultants become members of IMC to enhance their practice through numerous IMC programs and services. Through membership in IMC they demonstrate their commitment to the profession.

Who is eligible?

Individuals who are interested in, or otherwise participate in the management consulting profession are eligible to join IMC as a Regular Member. Individuals who have successfully completed the certification process are eligible for Certified Membership.

Certification

Management consultants who devote at least 60% of their time to their consulting practice, have a bachelor's degree from an accredited college or university, or equivalent training, and a three-year minimum of full-time independent consulting experience are eligible to apply for the Certified Management Consultant (CMC) designation. IMC's exacting certification process is designed to measure the candidate's professional competence. CMCs use the designation to distinguish themselves from other consultants and to demonstrate their professionalism to clients.

CMC Referral Service

CMCs benefit from a free Certified Management Consultant Referral Service offered to the general public. CMCs categorize themselves by their areas of specialty and industry. IMC handles the rest -- we maintain CMC information in our database and respond to potential client requests usually within 48 hours. IMC provides customized reports listing CMCs who appear to match the clients' needs.

Member Benefits:

Education and Information

Certified Management Consultant (CMC)
Certification Program*
Natinnal Workshops and Professional Development Meetings
Local Chapter Programs
IMC Communicator monthly Newsletter
Special Interest Groups
Journal of Management Consulting Subscription
IMC Directory of Members

Networking

International Reciprocity for CMCs
National Annual Conference
Western Confab
Local Meetings and Workshops

Marketing and Promotion

Listing in Directory of Members
CMC Referral Service
Member-to-Member Referrals

Money-Saving Programs

Reduced Fees for Annual Conference
Reduced Fees for Consulting Skills Workshop
Health Insurance Program
Errors & Omissions Insurance Program
Airborne Express Discounts
Alamo Rental Car Discounts
Penny-wise Office Supply Discounts
Business Week Subscription Discounts
Irwin Professional Publications Discounts

**IMC administers the Certified Management Consultant (CMC) designation program. It is the preeminent distinction earned by management consultants*

Fees & Dues Schedule

Category	Application Fee	Entrance Fee	Annual Dues
Member	$50	None	$120
Certified Member	$100	$150	$300
*Inactive Certified Member	N/A	N/A	$120
Reinstated Certified Member	$100	N/A	$300
Reinstated Member	$100	N/A	$120

**Transfer from Certified Member*

Notes: Non-member Certification Fees are as follows
Application Fee $150 Entrance Fee $450

Payments to IMC are not deductible as charitable contributions for federal income tax purposes. However, dues payments and other fees may be deductible as ordinary and necessary business expenses

Management Consulting
A Workshop For Professionals

Each year the Institute hosts a series of workshops designed to provide practical techniques that help consultants polish their skills. Participants will review the consulting process, the art of developing strong client relationships, and the strategies necessary to build successful professional practices.

Participants will:

- Master sales call techniques that work
- Discover tools that help develop winning proposals
- Enhance their consulting abilities and effectiveness through other practical knowledge

Call the Institute of Management Consultants for the current schedule and registration information.
Regular business hours: 9 a.m. - 5 p.m.: (212) 697-8262

LIBERTY MANAGEMENT CONSULTANTS
P.O. Box 3303, Johnstown, PA 15904-0303 (814) 266-7990

CONFIDENTIAL

April 9, 1996

Mr. David Anderson
Executive Director
NWIRC
Unitlow Center
1525 E. Lake Road
Erie, PA 16511-1031

Dear Dave,

As you recommended, I have been working with your Frank DeNapoli, in trying to engage my consulting services with a manufacturing client in NWIRC's region. Frank has been assisting me, but unfortunately we have been unsuccessful to date in obtaining a project. On February 3, 1994 Frank gave my brochures to Breezewood, Inc., Reynoldsville, PA (Jefferson County) and recommended to them that I evaluate Breezewood's financial and manufacturing capabilities of manufacturing their new wood-cutting saw for profit or sell it to a larger company. Frank subsequently told me that SPIRC consultant's were engaged instead.

Nevertheless, I maintained contact with Breezewood in anticipation of obtaining an engagement. Infact, on February 14, 1996, Breezewood told me that they were considering using my consulting services for a long term project and asked me to call them in April, 1996. I called on April 4, 1996 and was told that SPIRC consultants were presently working on a layout project at Breezewood. I immediately called Frank DeNapoli and told him. He said that he was not aware of SPIRC consultants working at Breezewood.

I would like to have been considered for this project, because I have an excellent background in plant and work station layout as well as developing manufacturing cells. I performed this type of work for the New Pig Corporation last year and generated $200,000 annual savings for a $25,000 fee. While employed with Armstrong World I justified, laid-out and staffed a production line. I also served as the lead engineer in justifying laying-out, staffing and operating a $100 million, 1000 employee would class seamless steel tubing facility for the former Babcock and Wilcox Company.

I would appreciate it if you and Frank would look into the Breezewood matter and hopefully salvage an engagement for me or perhaps find me another comparable project. It is my understanding that SPIRC is not supposed to operate out of their region. Frank told me that SPIRC consultants have performed engagements in your region without notifying him. John Maylie told me that the same thing has occurred in IMC's region. This creates a problem for me because I have been trying to market my services outside of SPIRC's region, as suggested by Ms. Terri Kaufman of the Pennsylvania Commerce Department.

Thank you.

Sincerely,

Bob Parsons

H. Robert Parsons
President

cc: Thomas B. Hagen, Secretary of Commerce

CONFIDENTIAL

To: Maria Stopher - NIST-MEP Fax (301) 963-6556

BEDFORD REINFORCED PLASTICS (BRP) ABBREVIATED CHRONOLOGY OF EVENTS

2/16/94 I met with BRP's top management team, including President Brian Stahl, to present my management consulting services. They subsequently told me that they decided to engage consultant Hal Clines to perform a TQM project. BRP asked me to call them in March, 1995 to be considered for their 1995 consulting project. I called them and made subsequent calls.

8/15/95 Brad Wise, BRP's Controller, told me that they received $10,000 grant for Hal Clines' TQM project from SPIRC, which was still in progress and no "hard" savings generated.

1/17/95 I called Jerry Conway, an engineer with BRP. He indicated that Hal Clines was wrapping-up his TQM project and they were considering engaging a consultant to analyze their plant operations. I told him that I performed that type of study for the New Pig Corp., Tipton, PA, and recommended $200,000 annual recurring savings for a $25,000 fee, yielding an 8:1 payback. Mr. Conway asked about my fee, requested my brochure, and said that he would meet with BRP's Operation Manager, Doug Buzzard. Mr. Conway also said BRP would request a grant from SPIRC, as they have in the past.

I made several follow-up calls to BRP, asking for Mr. Conway and Mr. Buzzard, but none were returned.

2/12/96 Jerry Conway responded to my call and said that they could not use me. They had SPIRC consultants working for them.

COMMENTS

- BRP is in Bedford County which is outside of SPIRC's region.
- SPIRC may have funded Hal Clines' BRP project with NIST-MEP funding.
- The $10,000 funding of one project is twice the amount normally funded, according to SPIRC policy.
- SPIRC may have taken advantage of BRP's grant inquiry to employee their own consultants. If so, that would be a conflict and unethical.
- Are MEP/SPIRC grants intended to fund recurring annual projects for profitable companies?
- If SPIRC is performing plant operations studies with non-degreed industrial engineers, they may be underqualified.
- What has occurred with SPIRC at BRP, has occurred with other companies and affected me.
- What has occurred here with SPIRC and me has occurred with other management consultants that I can identify.
- It is very difficult for me to pay my federal and state income taxes and pay my electric bill, knowing that these sources fund MEC's (PA IRC's) that are exempt from paying income taxes and compete against me. In particular, SPIRC may be using underqualified consultants and employing unethical practices to undercut me.
- I submitted proposals to conduct assessment studies for three (3) PA IRC's: MANTEC, IMC, and NWIRC. MANTEC and IMC are using NIST-MEP funds obtained from the Delaware Valley IRC to hire additional personnel to perform assessment studies.
- Two (2) months from today I'll be 60 years old, I have a sick wife (MS) and two teenage daughters to educate. One recently dropped-out of college because her funding depleted. In 3½ years I have contacted 350 potential clients and engaged only 2 clients to realize a total gross income of $60,000, prior to paying of taxes and expenses. How am I supposed to provide for my family, under these circumstances if I can't get work?

If you decide to investigate this matter, I will be glad to meet with you anytime. Please keep the contents of this letter confidential.

Sincerely,

H. Robert Parsons
President
Liberty Management Consultants

CONFIDENTIAL

To: Maria Stopher - NIST-MEP Fax (301) 963-6556

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If you decide to investigate this matter, I will be glad to meet with you anytime. Please keep the contents of this letter confidential.

Sincerely,

H. Robert Parsons
President
Liberty Management Consultants

I

104TH CONGRESS
1ST SESSION

H. R. 28

To require that the Federal Government procure from the private sector the goods and services necessary for the operations and management of certain Government agencies, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 4, 1995

Mr. DUNCAN introduced the following bill; which was referred to the Committee on Government Reform and Oversight

---

A BILL

To require that the Federal Government procure from the private sector the goods and services necessary for the operations and management of certain Government agencies, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Freedom from Government Competition Act of 1995".

SEC. 2. FINDINGS.

The Congress finds and declares that—

(1) private sector business concerns, which are free to respond to the private or public demands of the marketplace, constitute the strength of the American economic system;

(2) competitive private enterprises are the most productive, efficient, and effective sources of goods and services;

(3) Government competition with the private sector of the economy is detrimental to the American economic system;

(4) Government competition with the private sector of the economy is at an unacceptably high level, both in scope and in dollar volume;

(5) current law and policy have failed to address adequately the problem of Government competition with the private sector of the economy; and

(6) it is in the public interest that the Government establish a consistent policy to rely on the private sector of the economy to provide goods and services necessary for or beneficial to the operation and management of Government agencies and to avoid Government competition with the private sector of the economy.

SEC. 3. DEFINITIONS.

As used in this Act the term "agency" means—

1 (1) an executive department as defined by sec-
2 tion 101 of title 5, United States Code;
3 (2) a military department as defined by section
4 102 of such title; and
5 (3) an independent establishment as defined by
6 section 104(l) of such title.

7 **SEC. 4. PROCUREMENT FROM PRIVATE SOURCES.**

8 (a) GENERAL RULE.—Notwithstanding any other
9 provision of law, each agency shall obtain all goods and
10 services necessary for or beneficial to the accomplishment
11 of its authorized functions by procurement from private
12 sources unless—
13 (1) the goods or services are required by law to
14 be produced or performed, respectively, by the agen-
15 cy; or
16 (2) the head of the agency determines and cer-
17 tifies to the Congress in accordance with regulations
18 promulgated by the Director of the Office of Man-
19 agement and Budget that—
20 (A) Government production, manufacture,
21 or provision of a good or service is necessary for
22 the national defense;
23 (B) a good or service is so inherently gov-
24 ernmental in nature that it is in the public in-

terest to require production or performance, respectively, by a Government employee; or

(C) there is no private source capable of providing the good or service.

(b) REGULATIONS.—The Director of the Office of Management and Budget shall promulgate such regulations as the Director considers necessary to carry out subsection (a).

SEC. 5. STUDY AND REPORT.

The Director of the Office of Management and Budget, in conjunction with the Comptroller General of the United States, shall carry out a study to identify all current activities of agencies which are inconsistent with the requirements of section 5(a) and shall transmit to the Congress within one year after the date of enactment of this Act a report on such study. The report shall include a list of all activities identified under the preceding sentence and a schedule for the transfer of such activities to the private sector of the economy. The schedule included in the report shall provide for the completion of the transfer within 5 years after the date on which such report is transmitted to the Congress.

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II

104TH CONGRESS
2D SESSION

S. 1724

To require that the Federal Government procure from the private sector the goods and services necessary for the operations and management of certain Government agencies, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MAY 2, 1996

Mr. THOMAS introduced the following bill; which was read twice and referred to the Committee on Governmental Affairs

---

A BILL

To require that the Federal Government procure from the private sector the goods and services necessary for the operations and management of certain Government agencies, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

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This Act may be cited as the "Freedom from Government Competition Act of 1996".

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Congress finds and declares that—

(1) private sector business concerns, which are free to respond to the private or public demands of the marketplace, constitute the strength of the American economic system;

(2) competitive private enterprises are the most productive, efficient, and effective sources of goods and services;

(3) Government competition with the private sector of the economy is detrimental to the American economic system;

(4) Government competition with the private sector of the economy is at an unacceptably high level, both in scope and in dollar volume;

(5) current law and policy have failed to address adequately the problem of Government competition with the private sector of the economy; and

(6) it is in the public interest that the Government establish a consistent policy to rely on the private sector of the economy to provide goods and services necessary for or beneficial to the operation and management of Government agencies and to avoid Government competition with the private sector of the economy.

1 **SEC. 3. PROCUREMENT FROM PRIVATE SOURCES.**

2 (a) GENERAL RULE.—Notwithstanding any other
3 provision of law, except as provided in subsection (b), each
4 agency shall obtain all goods and services necessary for
5 or beneficial to the accomplishment of its authorized func-
6 tions by procurement from private sources.

7 (b) EXCEPTIONS.—Subsection (a) does not apply to
8 the following goods and services required by an agency:

9 (1) Goods or services that are required by a law
10 enacted after the date of the enactment of this Act
11 to be produced or performed, respectively, by the
12 agency.

13 (2) Any goods or services for which the head of
14 the agency determines and certifies to Congress in
15 accordance with regulations promulgated by the Di-
16 rector of the Office of Management and Budget
17 that—

18 (A) it is necessary in the interests of na-
19 tional security that the Government produce,
20 manufacture, or provide the goods or services;

21 (B) the goods or services are so inherently
22 governmental in nature that it is in the public
23 interest to require production or performance,
24 respectively, by Government employees; or

(C) commercial practices are not sufficient to satisfy unique requirements of the agency for the goods or services.

SEC. 4. PROCUREMENTS FROM STATE AND LOCAL GOVERNMENTS.

In any case in which the head of an agency determines that goods or services required by the agency are so inherently governmental in nature that it is in the public interest to require production or performance, respectively, by Government employees, the head of the agency shall determine whether the requirements of the agency for such goods or services can be satisfied by a State or local government and, if so, shall attempt to procure the goods or services from that source.

SEC. 5. ADMINISTRATIVE PROVISIONS.

(a) REGULATIONS.—

(1) IN GENERAL.—The Director of the Office of Management and Budget shall promulgate such regulations as the Director considers necessary to carry out sections 3 and 4.

(2) EMPHASIS ON PROCUREMENT FROM PRIVATE SOURCES.—The regulations shall emphasize the preference set forth in section 3 for procuring goods and services from private sources.

(b) OVERSIGHT.—The Director of the Office of Management and Budget and the heads of agencies shall vigorously monitor the compliance of agencies with the requirements of this Act and report to Congress any significant failure of an agency to comply with any such requirement.

SEC. 6. STUDY AND REPORT.

(a) STUDY.—The Director of the Office of Management and Budget shall carry out a study to identify all activities of agencies that are inconsistent with the requirements of section 3.

(b) REPORT.—

(1) REQUIREMENT.—The Director shall transmit a report on the study to Congress within one year after the date of enactment of this Act.

(2) CONTENT.—The report shall include a list of all procurement activities identified by the study and a schedule for the transfer of such activities to the private sector of the economy. The schedule included in the report shall provide for the completion of the transfer within five years after the date on which such report is transmitted to Congress.

(c) COORDINATION WITH COMPTROLLER GENERAL.—The Director—

(1) shall coordinate the study under subsection (a) and the preparation and transmittal of the re-

1 port under subsection (b) with the Comptroller Gen-
2 eral of the United States; and
3 (2) in preparing the study, shall obtain rep-
4 resentative views of the private sector.

5 **SEC. 7. DEFINITIONS.**

6 (a) AGENCY.—As used in this Act, the term "agency"
7 means—
8 (1) an executive department as defined by sec-
9 tion 101 of title 5, United States Code;
10 (2) a military department as defined by section
11 102 of such title; and
12 (3) an independent establishment as defined by
13 section 104(l) of such title.
14 (b) INHERENTLY GOVERNMENTAL SERVICES.—(1)
15 For the purposes of section 3(b)(2)(B), services constitut-
16 ing the performance of an inherently governmental func-
17 tion shall be considered inherently governmental services.
18 (2)(A) For the purposes of paragraph (1), a function
19 shall be considered an inherently governmental function
20 if the function is so intimately related to the public inter-
21 est as to mandate performance by Government employees.
22 Such functions include activities that require either the ex-
23 ercise of discretion in applying Government authority or
24 the making of value judgments in making decisions for
25 the Government, including judgments relating to monetary

1 transactions and entitlements. An inherently governmental
2 function involves, among other things, the interpretation
3 and execution of the laws of the United States so as to—
4 (i) bind the United States to take or not to take
5 some action by contract, policy, regulation, author-
6 ization, order, or otherwise;
7 (ii) determine, protect, and advance its eco-
8 nomic, political, territorial, property, or other inter-
9 ests by military or diplomatic action, civil or crimi-
10 nal judicial proceedings, contract management, or
11 otherwise;
12 (iii) significantly affect the life, liberty, or prop-
13 erty of private persons;
14 (iv) commission, appoint, direct, or control offi-
15 cers or employees of the United States; or
16 (v) exert ultimate control over the acquisition,
17 use, or disposition of the property, real or personal,
18 tangible or intangible, of the United States, includ-
19 ing the control or disbursement of appropriated and
20 other Federal funds.
21 (B) For the purposes of paragraph (1), inherently
22 governmental functions do not normally include—
23 (i) gathering information for or providing ad-
24 vice, opinions, recommendations, or ideas to Govern-
25 ment officials; or

1 (ii) any function that is primarily ministerial or
2 internal in nature (such as building security, mail
3 operations, operation of cafeterias, housekeeping, fa-
4 cilities operations and maintenance, warehouse oper-
5 ations, motor vehicle fleet management and oper-
6 ations, or other routine electrical or mechanical serv-
7 ices).

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